STATE OF MARYLAND
PARRIS N. GLENDENING
GOVERNOR

PRELIMINARY REPORT

OF

GOVERNOR'S COMMISSION ON BALTIMORE CITY

AUTOMOBILE INSURANCE RATE REDUCTION

SEPTEMBER 1, 1995

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EXECUTIVE SUMMARY

The Governor's Commission on Baltimore City Automobile Insurance Rate Reduction focused on six major areas affecting the cost of automobile insurance in Baltimore City:

1. Multiple Recoveries: The Commission found that persons injured in automobile accidents may receive multiple recoveries for the same bodily injury. For example, a claimant may receive reimbursement for the same injury from health insurance, personal injury protection (PIP) and a liability settlement. The Commission found that these multiple recoveries contribute to the high cost of automobile insurance in Baltimore City. To ensure that claimants do not receive multiple recoveries for the same injury, the Commission recommends that personal injury protection (PIP) cover only those costs and losses not otherwise covered by the claimant's health and disability insurance and that recoveries under uninsured motorist (UM) coverage and third-party liability coverage be reduced by compensation or recoveries that the claimant receives from other sources.

2. Medical Costs And Attorney Involvement: The Commission found that medical costs, particularly for soft-tissue injuries, and attorney involvement in bodily injury claims contribute to the high cost of automobile insurance in Baltimore City. To reduce medical costs, the Commission recommends that insurance companies be permitted to offer a managed-care option for personal injury protection (PIP) and that major insurers and the Maryland Automobile Insurance Fund (MAIF) be required to offer a PIP managed-care option for the treatment of soft-tissue injuries. The Commission also recommends that reimbursement to health care providers for the treatment of soft-tissue injuries be contained at Medicare levels. To limit unnecessary attorney involvement in automobile accident claims, the Commission recommends that targeted direct-mail solicitations to automobile accident victims and their relatives by attorneys be

prohibited for 30 days following the accident.

3. Fraud: The Commission found that fraud significantly increases the cost of automobile insurance in Baltimore City. To reduce the number of fraudulent insurance claims, the Commission recommends that (i) claimants be required to show evidence of physical contact in order to recover uninsured motorist (UM) benefits in a hit-and-run accident, (ii) an accident reporting unit be established within the Baltimore City police department as a pilot program, funded by the insurance industry, to prepare and file accident reports, (iii) the Insurance Fraud Division be required to refer evidence of attorney and health care provider fraud to the appropriate licensing and disciplinary boards and licensing and disciplinary boards be required to report to the Insurance Fraud Division on those cases in which no disciplinary action is taken, (iv) the license of any attorney or health care provider convicted of insurance fraud be revoked and (v) payments to "runners" who direct or refer automobile accident victims to attorneys or health care providers be prohibited. In addition, to reduce the costs associated with fraudulent applications for automobile insurance, the Commission recommends that insurers be permitted, immediately and without prior notice, to cancel and rescind the policy of any insured who procures automobile insurance by purposely misrepresenting material facts on an automobile insurance application if the material misrepresentation is discovered before a claim is made and that insurers be permitted to deny first-party benefits to the insured if the material misrepresentation is discovered after a claim is made.

4. Mandatory Coverages: The Commission found that drivers are required by law to purchase first-party automobile insurance coverages that they may not need and do not want and that these unnecessary and unwanted coverages add substantially to the cost of automobile

insurance in Baltimore City. The Commission recommends that both personal injury protection (PIP) and uninsured motorist (UM) coverage be fully optional.

5. Territorial Rating: The Commission found no credible evidence of intentional racial discrimination in the rate-making practices of automobile insurers. However, the Commission did receive evidence to suggest a possible correlation between the racial composition of rating territories and automobile insurance rates. To assure that territorial rating practices are free of unfair discrimination, as required by law, the Commission recommends that the Insurance Commissioner (i) adopt regulations to define the "underlying risk considerations" that insurers may use in establishing rating territories, and (ii) investigate the possible correlation between the racial composition of rating territories and automobile insurance rates and, if appropriate, adopt regulations on territorial rating, within the existing statutory framework and without arbitrarily shifting costs from one territory to another, that will ameliorate the impact of territorial rating on African-Americans in Baltimore City and elsewhere.

6. Highway Safety: The Commission found that preventable automobile accidents and preventable injuries in automobile accidents contribute to the high cost of automobile insurance in Baltimore City and the cost of automobile insurance throughout the State. Therefore, the Commission recommends that certain highway safety measures be adopted in Maryland that have proved successful in other States in reducing the number of automobile accidents and the medical costs associated with automobile accidents. These include (i) cameras at high-risk intersections to photograph red-light violations; (ii) primary enforcement of seat-belt and child-restraint laws and (iii) prohibition of radar detectors.

INTRODUCTION

On February 20, 1995 Governor Parris N. Glendening signed Executive Order 01.01.1995.05, establishing the Governor's Commission on Baltimore City Automobile Insurance Rate Reduction (Exhibit 1). The Commission was established to examine those factors which contribute to high automobile insurance rates in Baltimore City and to make recommendations to the Governor that will reduce these rates. In particular, the Commission was to examine rating practices by insurers, the influence claimant behavior has on insurance rates, and the roles of attorneys and health care providers on Baltimore City rates. In addition, the Commission was charged with examining the role of the Maryland Automobile Insurance Fund (MAIF), Maryland's insurer of last resort in the automobile insurance market.

The Commission comprised 17 members of diverse backgrounds, experience and interests. Pursuant to the Executive Order, the President of the Maryland Senate designated Senators Thomas L. Bromwell, Martin G. Madden and John A. Pica, Jr. to serve on the Commission, and the Speaker of the Maryland House of Delegates designated Delegates Michael E. Busch, Cornell N. Dypski and Charles A. McClenahan to serve on the Commission. Mayor Kurt L. Schmoke (represented by Kevin S. O'Keeffe) and Baltimore City Councilman Melvin L. Stukes served on the Commission through designation by the Mayor of the City of Baltimore. Insurance Commissioner Dwight K. Bartlett, III, served on the Commission pursuant to the Executive Order. Governor Glendening appointed 8 members of the general public to serve on the Commission: Shelli Craver, State Director, Citizen Action of Maryland; Theresa V. Czarski, Esquire; Philip O. Foard, Esquire; David M. Funk, Esquire; Gregory N. Gill, Esquire; Arthur W. Lambert, President, Lambert Insurance Agency, Inc.; James R. Lewis, Senior Vice

President, United States Fidelity and Guaranty Company; and Mrs. Martha C. Roach. The Governor appointed Mr. Funk to serve as Chairman.

Governor Glendening announced the formation of the Commission as part of a major automobile insurance reform initiative to address the dual problems of availability and affordability of automobile insurance in Baltimore City. House Bill 923 (1995), sponsored by the Governor and passed during the 1995 Session of the General Assembly, addressed the issue of availability by requiring most major insurers to develop a marketing plan for Baltimore City and requiring them to market their products in Baltimore City in the same manner as in other parts of the State. The bill also addressed one of the major factors, identified by the Commission in this Report that increases insurance rates, insurance fraud, by reconstituting the Insurance Fraud Unit as the Insurance Fraud Division of the Maryland Insurance Administration (MIA) and increasing the funding for the Insurance Fraud Division.

While methods for reducing automobile insurance are the subject of debate before this Commission and in most other states, the fact that rates for City residents are high is not debatable. As can be seen in Exhibit 2, a comparative rate guide published by the Maryland Insurance Administration (MIA), rates for City residents are typically three times the rates for drivers in rural counties. In some cases, such as young drivers who can least afford to make payments, there is almost a five-fold difference in rates charged by some companies. Higher rates in the City are an additional financial burden on City residents, and are cited as one of the reasons residents choose to leave Baltimore City. Because automobile insurance is personal and compulsory, a meaningful reduction in automobile insurance rates is akin to tax relief.

The Commission began meeting on March 13, 1995, and held 8 public hearings through

May 17, 1995. The Commission held 5 additional meetings between July 24 and August 28, 1995, to review and to hear testimony on a draft of the Preliminary Report. In all, over 40 hours of hearings were devoted to receiving testimony and comments from interested parties. In addition, the Commission received hundreds of pages of written materials, providing data, analysis and opinion regarding the issues before the Commission. The Commission has drawn heavily on these materials in preparing this Report.

Part I of this Preliminary Report represents the analysis by the Commission of the testimony and materials received, and the findings of the Commission based on the testimony and material considered. Part I is divided into four Sections: Section A discusses automobile insurance coverages that are mandated by Maryland law and the way in which these coverages may lead to multiple recoveries for the same injuries. Section B discusses the rating practices of automobile insurers and explores the justifications for, limitations on and challenges to territorial rating, including claims of unfair discrimination against City residents by insurers. Section C focuses on bodily injury claims and the ways in which these claims contribute to the cost of automobile insurance in Baltimore City. Section D examines the automobile insurance markets in Baltimore City and the ways in which private insurers and the Maryland Automobile Insurance Fund (MAIF) serve these markets. Commission findings are set forth at the end of each Section relating to the materials in that Section.

Part II of this Report contains the recommendations of the Commission.

PART I

DISCUSSION AND FINDINGS

SECTION A. AUTOMOBILE INSURANCE COVERAGE IN MARYLAND

In order to provide a foundation for its examination of those factors which cause high automobile insurance rates in Baltimore City, the Commission examined those coverages mandated by State law and the impact each coverage has on automobile insurance premiums.

1. Mandated Coverages

Like 40 other states, Maryland has a "financial responsibility" law.[1] The law applies to the owner of a motor vehicle, and mandates the owner provide evidence he or she will be able to respond financially in the case of an automobile accident. In the case of private passenger automobile insurance, the financial responsibility laws are typically satisfied through the purchase of an automobile insurance policy. The statutes refer to this evidence of financial responsibility as "required security." Although the requirements in Maryland are fairly typical of states that have "required security" laws, the particular requirements vary from state-to-state. Set forth below are the coverages that comprise the "required security" in Maryland. These coverages are broken down into two general categories: "third-party" coverage, which protects the insured from lawsuits from third parties, and "first-party" coverage which provides benefits directly to the insured from the insured's own insurance company.

a. Third-party Coverages

- Bodily Injury Liability (BI). This liability coverage indemnifies the owner of the vehicle from claims and lawsuits by third persons for injuries arising out of an automobile

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[1] § 17-101, Transportation Article, Md. Ann. Code

accident, up to specified limits of insurance contained in the policy. When benefits are paid under this coverage in the policy, they are paid to a third party, not the purchaser. Under Maryland law the "required security" for bodily injury liability (BI) coverage is $20,000 per person, and $40,000 for any two or more persons (per accident).

- Property Damage Liability (PD). This is another form of "third-party" coverage, but protects the insured from lawsuits for damage to the property of another person, such as a motor vehicle, rather than bodily injury to another person. In Maryland, the required security for property damage liability (PD) coverage is $10,000.

b. First-party Coverages

- Personal Injury Protection (PIP). Unlike BI coverage or PD coverage, PIP coverage is a "first-party" coverage.[2] This means that a driver recovers PIP benefits from his or her own insurance company. PIP benefits are paid without regard to the fault of the driver, so that even if a driver causes an accident, he may recover PIP benefits from his own insurer. PIP coverage is similar to health insurance coverage in that it provides first-party benefits for medical and hospital expenses. However, under Maryland law, PIP also pays benefits for lost income resulting from an automobile accident, reasonable and necessary expenses incurred for certain essential services usually performed by the injured party for family members, and funeral expenses. That statutory minimum for PIP coverage is $2,500. However, some insureds voluntarily purchase more than the statutory minimum.

PIP benefits are payable to the first-named insured in the policy, and members of that person's family residing in the household, persons using the insured's vehicle with permission,

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[2] § 539, Article 48A, Md. Ann. Code

passengers in the insured's vehicle, as well as pedestrians injured by the insured's vehicle. PIP benefits may be waived by the first-named insured on the automobile insurance policy, but that waiver does not apply to family members residing in the first-named insured's household under the age of 16, certain passengers, or certain pedestrians.

- Uninsured Motorist (UM). This coverage pays when an insured driver and certain others riding in the vehicle are injured by an uninsured or hit-and-run motorist.[3] UM is similar to "first-party" coverage in that it is paid by the insured's own insurance company. However, unlike PIP, UM is a fault-based coverage, and therefore has certain characteristics of third-party coverage. In Maryland, uninsured motorist (UM) coverage is by definition deemed to include "underinsured" coverage. In other words, if a purchaser of uninsured motorist (UM) coverage is involved in an automobile accident with an at-fault driver, and the at-fault driver has insurance (and therefore is not "uninsured"), but has BI coverage with limits of insurance that are less than the amount of UM coverage of the injured driver, then the UM coverage of the injured driver will be applicable over the amount of the at-fault driver's limit of liability.

In Maryland, the UM statute requires that the amount of BI uninsured motorist (UM) coverage under a private passenger motor vehicle insurance policy is equal to the amount of BI liability coverage purchased by the driver, unless the driver waives down to a lesser amount but, in no event, less than the statutory minimum for liability insurance ($20,000/$40,000/$10,000).

The law concerning the precise scope of mandatory UM coverage as it applies to property damage (PD) coverage is not described with precision in the Insurance Code. Several references in the Insurance Code suggest UM coverage was only intended to apply to BI, not PD coverage.

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[3] § 541(c)(1), Article 48A, Md. Ann. Code

For example, an "uninsured motor vehicle" is defined to mean a motor vehicle the use of which has resulted in "[t]he bodily injury or death of an insured", and for which the sum of "the limit of liability under valid and collectable liability insurance [policies]...is less than the amount of coverage provided [under the UM statute]".[4] No mention is made in the definition of property damage to the insured. Similarly, the language mandating the coverage refers only to bodily injury (BI) coverage.

> ...[E]very policy of motor vehicle liability insurance sold...in this state after July 1, 1975 shall contain coverage in at least the amounts required under [the required security law] for damages subject to the policy limit, which (i) the insured is entitled to recover from the owner or operator of an uninsured vehicle because of bodily injuries sustained in an [automobile] accident...[5]

The only reference to coverage for property damage is the provision which states: "In no case shall the uninsured motorist coverage be less than the coverage afforded a qualified person under Article 48A, §243H and 243I."[6] The references to 243H and 243I are to the Uninsured Division of the Maryland Automobile Insurance Fund (MAIF), which pays benefits, including property damage, to those persons suffering damage as a result of an uninsured or hit-and-run automobile accident and who are not covered by another applicable policy. The Commission received testimony that notwithstanding this lack of clarity, the MIA requires insurers to provide property damage (PD) coverage under UM coverage.

The Commission received testimony that the property damage (PD) portion of UM coverage is particularly susceptible to abuse and fraudulent claims. This possibility arises in

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[4] Id.

[5] § 17-101, Transportation Article, Md. Ann. Code

[6] § 541(C)(2)(v), Article 48, Md. Ann. Code

situations were an insured accidentally causes damage to his or her own vehicle. Representatives of the insurance industry testified that, in some cases, insureds may claim a "phantom" vehicle caused the insured to swerve into an object or run off the road, causing damage, enabling the insured to recover under his or her own UM coverage, which may have a lower deductible and is not a chargeable accident for surcharge or cancellation purposes.

2. Impact Of Mandated Coverages On Insurance Rates

The Commission examined the relative impact the different coverages have on the premium paid by a typical driver who purchases the statutory minimum. Exhibit 3 shows the components of MAIF's statutory minimum policy by coverage for a typical driver in Baltimore City. The bodily injury (BI) component of the premium is the largest, constituting almost one-half of the entire premium. PIP is second, constituting one-fourth of the overall premium. Clearly, proposals that would reduce these two components of the premiums would have the greatest overall impact on rates, since together they comprise 75% of the overall rate.

The Commission also examined the impact that the limited PIP waiver has had on automobile insurance rates in Maryland as well as the impact that a full PIP waiver would have on these rates. Exhibit 4 shows the effect of both a limited and full waiver on MAIF drivers in various territories. Although more MAIF drivers have waived PIP in Baltimore City than in any other jurisdiction and, as a consequence of the limited waiver, these drivers have reduced their premiums substantially, the data show that permitting drivers to waive PIP in full would result in a further substantial reduction in rates.

3. Multiple Recoveries

Multiple recoveries occur when different coverages or funding sources compensate

injured persons for the same injury. Testimony by the insurance industry suggested that multiple recoveries is a substantial contributor to high automobile insurance rates. Typically, multiple recoveries can be prevented by one or a combination of three mechanisms: subrogation by a health or disability insurer against the automobile insurer, reduction of judgments by amounts received from collateral sources, and coordination of benefits among first-party coverages. Although the subject of multiple recovery and its impact on insurance rates is discussed more fully in Section C, there are several statutory provisions relating to the mandated coverages that allow for (and in some cases prohibit) multiple recoveries.

Maryland law does not require judgments to be reduced by amounts received from health insurers, disability insurers or other collateral sources. Thus, in the case where an automobile accident victim has received payments from his or her own health insurer and/or PIP insurer for medical bills, those same bills are also paid by the at-fault person's insurer under that person's BI coverage. This means that in some cases, BI coverage is used to make duplicative payments.

Maryland law also does not permit PIP benefits to be reduced by payments from collateral sources.[7] Again, this means that in many cases benefits recovered under an insured's PIP coverage are also recovered from several other possible sources including, as noted above, the at-fault party's BI insurer. If bills are first submitted to the health insurer, they may also be submitted to the PIP carrier for payment.

The Commission notes that a recent case decided by the Circuit Court for Howard County has called into question this interpretation of the PIP statute, at least as it relates to

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[7] § 540(a), Article 48A, Md. Ann. Code

HMOs.[8] In that case, the victim received treatment for automobile accident injuries from his HMO. He then sought payment for that treatment from his PIP insurer. The Court cited the language of the PIP statute, which obligates PIP insurers for reasonable expenses arising out of an automobile accident if "incurred" within three years, and ruled that the PIP insurer had no duty to make payment because the victim had not "incurred" any medical expenses because all treatment was rendered by the HMO. Whether this case, which could limit the opportunity for double recoveries from HMOs and possibly health insurers, will be upheld cannot be known at this time.

However, in the case where an insured has coverage for PIP-type benefits from another first-party coverage, such as health insurance, the law permits, but does not require, insurers to coordinate these coverages so that the insured is paid benefits without duplication.[9] The law requires that in cases where insurers coordinate coverages, they must make appropriate reductions in premiums for the "reduced" coverage (i.e. nonduplicative coverage). The testimony before the Commission was that health insurers more often seek to coordinate benefits than do PIP carriers. As a consequence, PIP coverage is normally considered the "primary" coverage for the payment of medical bills in the case of an automobile accident.

Some parts of the PIP statute expressly prohibit certain double recoveries. For example, the law explicitly prohibits an insured from "stacking", that is, recovering PIP benefits from two motor vehicle insurance policies, and also requires that PIP benefits are reduced to the extent

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[8] Campbell v. State Farm, Circuit Court for Howard County, Case No. 94-CA-24244, August 3, 1995.

[9] § 540(b), Article 48A, Md. Ann. Code

that the recipient "has recovered" benefits under State or federal workers compensation laws.[10] Thus, there are some cases where the PIP statute specifically prohibits double recovery.

FINDINGS:

1. The bodily injury (BI) and PIP components of the premium represent the two largest components of the typical total premium for automobile insurance in Baltimore City. Consequently, recommendations that focus on these two components will have the greatest impact on reducing rates in Baltimore City.

2. Even though the law authorizes an insured to waive a portion of the PIP coverage, PIP still constitutes a substantial portion of a driver's premium because PIP may not be waived as to all parties.

3. Because PIP is paid without regard to fault and without regard to collateral sources such as third-party BI liability insurance payments, and in some cases, first-party health insurance, the statutory scheme in Maryland permits duplicative recovery of certain damages arising out of automobile accidents. Insurance consumers pay for the cost of providing multiple recoveries to accident victims.

[10] § 543, Article 48A, Md. Ann. Code

SECTION B. TERRITORIAL RATING

One of the charges to the Commission in the Governor's Executive Order is to examine the rating practices of insurance companies. The Commission therefore received and considered oral and written testimony, primarily from the insurance industry, relating to the manner in which automobile insurance premiums are established. The insurance industry presented the business and actuarial basis for current rate-making practices. The Commission also received testimony relating to the legal requirements and constraints relating to rate-making, and objections to one particular rate-making practice, that of territorial rating.

1. Cost-based Pricing

As a general proposition, insurance is a risk management technique that allows insureds to reduce the financial uncertainty that results from their inability to predict future losses. Insureds pay a premium to an insurer in exchange for having the insurer bear the risk of loss if the insured suffers a loss. Insurers assume the risks of loss by spreading the costs of all risks among a large number of similarly situated insureds, each of whom pays a relatively small but certain amount in the form of a premium. The process of establishing insurance rates is complex. The basic objective of rate-making is to establish a premium that will cover the expected losses and expenses of the insurer for the coverage that is being rated.[11] Generally speaking, insurers examine the past losses of the largest possible number of insureds, which they in turn use to estimate their probable future losses. These past losses are also considered in light of factors which may impact their costs in the future. For example, losses incurred in the future may be more costly than past losses if the cost of health care in general is rising. Rates also

[11] Interim Report of the National Association of Insurance Commissioners (NAIC) Availability and Affordability Task Force, December 6, 1994, p. 20

include factors for general expenses and profits, among other factors.

That aspect of rate making which in large part has given rise to the establishment of the Commission is the practice of insurers classifying insureds into categories for the purpose of charging different rates to insureds in different classifications based on historic loss costs of those classifications. Typical classifications of risk used by automobile insurers include age, gender, and place of residence or geography.

The Interim Report of the National Association of Insurance Commissioners, Insurance Availability and Affordability Task Force, summarized the role of risk classification in the following manner:

> The goal of risk classification is to create groupings of a similar prospective risks of loss so that the people, property, or vehicles with a higher risk of loss pay a larger amount of premium.... [T]here are many ways to group risks through rate classifications, so that the premium collected from a group of insureds will cover the expected losses from that group. Broader rating classes represent a larger grouping of risks, while smaller rating classes present a more detailed segmentation of the market.[12]

According to testimony from the insurance industry, the justification for the use of risk classification, such as rating territories based on geography is that of "cost-based" pricing. This concept was justified to the Commission by a representative of the insurance industry in the following manner:

> One of the basic principles in pricing an insurance policy is that the price should reflect the cost of providing the coverage, plus a reasonable margin for profit. This is not a principle unique to insurance pricing but is widely followed in other competitive areas in an economy based upon private enterprise. Cost-based pricing is, in fact, the economic or allocational standard of fairness typically applied to the marketplace.[13]

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[12] Id.

[13] Statement of Mavis Walters, Executive Vice President, Insurance Services Office, Inc.

One representative of the industry presented several "principles" of rate-making promulgated by the Casualty Actuarial Society in support of the practice of cost-based pricing.[14] For example, these principles require that "each policy should be priced at the level of risk associated with that policy." In addition, a rate should minimize "anti-selection." In other words, if a risk classification is not relatively homogenous, those with expected losses higher than the group's expected losses will find that rate attractive; however, those with lower expected losses will find the rate too high, and may chose not to insure. The loss of these good risks worsens the total experience of the class.

The Commission takes note of the fact that the testimony relating to the rationale for risk classification was not always consistent, with some testimony suggesting it is done in the best interests of consumers, and other testimony suggesting it is done in the best interests of the insurers themselves. On the one hand, testimony received by the Commission from the industry, such as the described above, suggested that cost-based pricing was dictated by "fairness" to insureds: those who presented the highest risk should pay the highest premium, and vice versa. However, other representatives of the industry conceded that the drawing of territories is done for essentially competitive reasons.[15] That is, to the extent that insureds residing in geographic areas with lower loss costs can be separated from insureds residing in higher cost areas, the insurer can charge the less "risky" group a lower premium, which in turn increases that insurer's competitive advantage. In other words, the consequence for an insurer for failing to parse insureds into the smallest possible risk classifications is that another insurer, having done so, will

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[14] Id.

[15] Testimony of Parker Boone, Actuary, Tillinghast.

increase its market share with the best risks. The industry responds that these two goals, fairness and competitive advantage, are not inconsistent.

In the specific case of automobile insurance, the "cost" to the insurer to provide the product is composed primarily of the projected losses and expenses of a particular insured based on his or her particular classification. Insurers must project losses and expenses for the policy period because the actual losses and expenses are not known until actually incurred. Insurance companies project future costs based on past losses for a particular classification. These past losses are referred to as the "loss cost," or "pure premium." These two terms are interchangeable and refer to:

> the total dollars of loss per insured vehicle. It is computed by dividing the total dollars of loss for a specified coverage by the number of insured vehicles.[16]

As described in the testimony by the industry presented to the Commission, the loss costs are influenced by two primary factors: the number of claims per insured vehicle (frequency), and the average dollars of loss per claim (severity).[17] By multiplying the claims frequency, i.e., the number of claims per insured vehicle, by the average dollar of loss for each claim, i.e., the severity of the claim, the total dollars of loss per insured vehicle can be determined.

Exhibit 5 illustrates the principles of cost-based pricing and risk classification. The chart shows loss cost data for each of 9 territories in the State, based on claim frequency and severity. Severity and frequency are further broken down by the types of coverages discussed in the preceding Section. The data presented in the Exhibit show that the pure premium or loss costs

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[16] Testimony of Elizabeth Sprinkel, Director of Research, Insurance Research Counsel, Inc. (IRC), and generally, IRC Report, "Auto Injuries: Claiming Behavior and its Impact on Insurance Costs", September 1994. See also ISO, Inc., "Factors Affecting Urban Auto Insurance Costs", December, 1988.

[17] Id.

vary by geographic territory and that residents in those high-cost territories will pay higher premiums that are reflective of the cost of the product that they purchase. For example, the average loss cost in Baltimore City is $305.67, as compared to $104.53 in Eastern Shore Counties.

2. Statutory Limitations

The Commission considered whether the practice of rate-making as described to the Commission is consistent with the requirements of the Insurance Code. Clearly, the Maryland Insurance Code explicitly recognizes and allows for the grouping of risks into classifications for the purposes of establishing rates and minimum premiums. Article 48A, §242(c)(4)(i) provides as follows:

> Risks may be grouped by classifications for the establishment of rates and minimum premiums. Classification rates may be modified to produce rates for individual risks in accordance with rating plans which establish standards for measuring variations in hazards or expense provisions, or both. The standards may measure any difference among risks that are demonstrated objectively to the Commissioner to have a direct and substantial effect upon losses or expenses.

The Insurance Code goes on to specifically recognize "territorial" rating:

> However, no rate may be based partially or entirely on geographic area itself, as opposed to underlying risk considerations, even though expressed in geographic terms.

The Commission examined material submitted by the Insurance Commissioner and others on the issue of territorial rating, including 2 different Attorney General's Opinions, and a 1990 report by the then Division of Insurance in the Department of Licensing and Regulation. Several conclusions can be drawn from this material.

First, according to the Attorney General, in general, this language permits insurers to charge different premiums to insureds residing in the City or parts of the City than to insureds

in other parts of the State. The Attorney General has opined that in light of this language "the Commissioner does not have the authority to disapprove a specific filing simply because rates differ from one territory to another."[18] Thus, the mere fact that rates are higher in Baltimore City does not per se render them unfairly discriminatory under the Insurance Code.

Second, the law also requires that rate differentials between territories be based on "underlying risk considerations" that substantially affect the losses and expenses of the insurer. This key phrase is at the crux of the debate over territorial rating, and is not defined in the Code. However, as the Attorney General noted in interpreting this provision several years after it was passed by the General Assembly, Maryland law allows for several factors to be considered in making rates, including past and prospective loss experience and expenses, both nationally and statewide. The Attorney General opined that based on credible loss data establishing higher loss costs in those territories with higher rates, "the geographical classifications make sense" and satisfy the statutory standard.[19] Therefore, while the Commissioner may not disapprove rates based solely on differences between territories, it is within the Commissioner's discretion to require that an insurer show the required link between geography and the underlying risk considerations with reasonably current actuarial data.

3. Challenges To Territorial Rating.

There as no direct evidence presented to the Commission to demonstrate that loss costs in the City or parts of the City are not higher than other parts of the State. However, the

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[18] Opinion letter from Attorney General Stephen H. Sachs to Edward J. Muhl, Insurance Commissioner, September 22, 1982.

[19] Opinion letter from Assistant Attorney General Carl E. Eastwick to Senator John Carroll Byrnes, May 9, 1977.

Commission received testimony that challenged the rating practices described above on two grounds.

First, the Commission heard testimony that the territories established by some insurers in which rates are highest are also those with the highest percentage of African-American drivers. Because of the disproportionate impact this rating practice has on the African-American community in Baltimore City, a complaint has been filed with the Maryland Human Relations Commission challenging the territorial rate disparities, and requesting that such rating practices be declared unlawful.

A second objection to the practice of territorial rating was described in an extensive report entitled "Underlying Risk Considerations: A Study of the Use of Territorial Rating For Private Passenger Automobile Insurance in Baltimore, Maryland". That study concluded that some insurers are engaged in a "systematic process of isolating the City from its county neighbors through the development of marketing and rating territories."[20] (As to the issue of exclusion by means of marketing strategies, the General Assembly addressed this issue with the passage of House Bill 923 (1995), sponsored by the Governor, in the 1995 Session. That bill imposes on most major insurers a duty to market in the City in the same manner as in the rest of the State.) The study argues that driving environments in the City and surrounding areas are similar and thus rates should not vary between adjacent territories to the extent they do. The study faults those factors currently considered used by insurers to be "underlying risk considerations" because they do not take into account the similar driving environments that typify territories, whose boundaries are adjacent, but whose rates vary dramatically. The study

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[20] R & B Unlimited, Inc., "Underlying Risk Considerations: A Study of the Use of Territorial Rating for Private Passenger Automobile Insurance in Baltimore, Maryland", January, 1993.

recommends the use of rate bands and other equalization measures to soften the disparities that exist between City and county residents.

The complaint filed with the Human Relations Commission and the study described above seek as a remedy to current rating practices the elimination of territorial rating. While the elimination of territorial rating would serve to lower the costs of insurance for City residents, or certain territories in the City, other territories would see a corresponding increase in their rates. Thus, the redrawing of territorial boundaries for the sole purpose of "reducing" insurance premiums for some residents only serves to redistribute and reallocate overall costs, and does not address underlying costs. The General Assembly has consistently rejected such an approach.

Although the Commission received no credible evidence of intentional race discrimination in automobile insurance rate-making, the Commission did receive evidence to suggest the possibility of a correlation between the rates charged in certain rating territories and the racial composition of those territories. The current law clearly prohibits discrimination in rating on the basis of race, color or national origin.[21] Therefore, while the Commission agrees that cost-based pricing is a legal and valid basis for rate-making, the Commission also believes that the Insurance Commissioner should further examine current territorial rating practices to ensure that these practices do not transgress existing prohibitions on discrimination based on race, color or national origin.

One basis for such an examination is the language of the law authorizing territorial rating. As noted in the R & B Unlimited report, the term "underlying risk considerations" in the rating law lies at the basis for all justifications for current practices by insurers. The

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[21] § 234A, Article 48A, Md. Ann. Code.

Commission notes that currently no regulations interpret this key phrase, particularly in light of statutes prohibiting discrimination. Although the Attorney General has upheld current rating practices, he has specifically recognized that discretion rests with the Insurance Commissioner to address this difficult issue. As stated in one opinion by the Attorney General:

> "...the policy decision on this issue is for the Insurance Commissioner...he would be acting equally within the scope of his discretion under the law were he to insist upon more exacting data that might result in geographic line drawing that departs from the traditional..."[22]

FINDINGS:

1. The practice of cost-based pricing, where drivers pay different premiums depending on the risk presented to the insurer by the driver, is a widely accepted and in general legitimate approach to the pricing of automobile insurance.

2. Redrawing territorial boundaries solely to equalize rates between territories, only serves to redistribute, not reduce costs.

3. Loss costs in Baltimore City exceed those in all other jurisdictions. As currently interpreted by the Insurance Commissioner and the Attorney General, these loss costs constitute underlying risk considerations for the purposes of the territorial rating statute.

4. The Insurance Commissioner's statutory authority with respect to the establishment of territorial boundaries is that of determining valid "underlying risk considerations" for the establishment of rating territories, requiring actuarial justification for the "underlying risk considerations" relied on by an insurer for the territory established and ensuring that impermissible factors, such as race, color, or national origin, played no role in establishing the

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[22] Letter from Attorney General J. Joseph Curran, Jr. to Mary Pat Clarke, President, Baltimore City Council, December 18, 1990.

territorial boundaries.

5. Although there is evidence to suggest that territories as currently configured may satisfy the legal requirements relating to what constitute permissible "underlying risk considerations" as interpreted by the Attorney General and the Insurance Commissioner, current law also prohibits discrimination in automobile rates based on race, color or national origin.

6. There may be a correlation in some cases between those territories with the highest rates and the African-American population of those territories. The Insurance Commissioner has the statutory authority to investigate and, if appropriate, to seek to address the correlation between high rates and African-American populations in rating territories.

SECTION C. BODILY INJURY CLAIMS

One of the charges to the Commission in the Governor's Executive Order is to examine the underlying costs of automobile insurance. As discussed in Section A and shown in Exhibit 3, the two coverages that comprise the majority of a typical automobile insurance premium and therefore contribute most to the cost of automobile insurance are those that respond to the bodily injury component of an automobile injury claim, the BI and PIP coverages. Therefore, the Commission received and considered oral and written testimony, primarily from the insurance industry, relating to these coverages and those factors which influence the costs of these coverages. Specifically, the Commission examined: 1) as background, these coverages in the context of the three general types of injury compensation systems in the United States; 2) the anatomy of a typical automobile injury case in Maryland and the role these coverages play in such a typical case; and 3) those factors relating to automobile injury claims that particularly influence the underlying costs of these coverages from a national perspective, as well as in Maryland in general and Baltimore specifically.

1. Injury Compensation Systems

States are grouped into three broad categories depending on the way in which injured parties recover damages in automobile insurance claims. The three basic classifications of state laws relating to automobile insurance are: no-fault, add-on, and tort.

In the traditional or "tort" approach to compensation, an injured party seeks compensation for economic losses and noneconomic losses, such as pain and suffering, from the person who caused the injury. This recovery is typically from the BI liability insurance of the at-fault party. In order to recover from a third party, injury victims must be prepared to prove fault on the part

of the third party. Twenty-seven states are considered "tort" states.

In 9 states and the District of Columbia, drivers rely on the tort system, and claims against at-fault third parties, in order to recover their economic and non-economic losses, but there is a statutorily mandated first-party coverage, such as the PIP coverage described in Section A above. These PIP benefits are essentially "no-fault" benefits, but there is no restriction on the right of an injured party to pursue a liability claim as there is under a true no-fault statute. Maryland is an "add-on" state because Maryland law mandates the purchase of first-party no-fault PIP benefits and Maryland law does not restrict the ability to sue third parties for damages.

Finally, there are so-called "no-fault" states, where state law restricts the right of injured parties to sue at-fault parties, and most economic damages such as medical bills, are paid to an injured party by that party's own PIP or no-fault coverage. In such states, PIP is mandated, but usually in an amount much higher than the $2,500 mandated in Maryland. The quid pro quo for the ability to receive payment for injuries without regard to the driver's own fault is the restriction on the driver's right to sue others. However, in none of these no-fault states is the right to sue absolutely prohibited. Each state law contains a "tort threshold" which allows for suit against an at-fault party if the injuries exceed the threshold set forth in the statute. Often these thresholds are described in monetary terms; however three states have laws that describe the threshold by describing in words the type of injuries that must be sustained, e.g., "serious" injury, before suit may be filed. These states are so-called "verbal" threshold states. Thus in no-fault states, drivers carry some BI coverage. Twelve states have no-fault laws, and three additional states have so-called "choice" no-fault laws, in which a vehicle owner has the option

of being insured under a no-fault policy or opting for a full "tort" option.

2. Factors Relating To Underlying Costs

According to the testimony received by the Commission from the insurance industry, the factor which most significantly impacts the claims cost to the insurer, which in turn impacts the premiums paid by the consumer, is the bodily injury loss costs, i.e. the total dollars of BI loss per insured vehicle.[23] Bodily injury loss costs are in turn dictated by severity of the average claim, that is the average dollars of loss per claim, and the frequency of claims, that is the number of claims per insured vehicle, in a particular territory.

There are several factors which in general affect claim frequency. For example, the higher the accident rate in a given area, the more likely it is claims will be filed more frequently. In turn, the accident rate may be affected by the vehicle congestion of the area. Urban areas have more cars than rural areas, so one would expect higher accident frequencies, and the data support this conclusion. Consequently, according to material submitted by the industry, insurance rates will tend to be higher in urban as compared to rural areas because objectively measurable conditions, such as traffic congestion and vehicle density, mean that the likelihood of an accident occurring is higher in cities.[24]

Claim severity is also influenced by many factors. These include the relative costs of health care in a given jurisdiction, the speed at which the accident occurs, and safety features

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[23] See note 16.

[24] See generally ISO, Inc., "Factors Affecting Urban Auto Insurance Costs"; Tillinghast, "Study of Private Passenger Automobile Liability Insurance System", November, 1990, prepared for the 1990 Governor's Commission on Insurance; IRC Report, "Trends in Auto Injury Claims" 2nd Edition, February, 1995 (hereinafter cited as "1995 IRC Report").

of the vehicle.[25]

a. National Trends

Before examining those factors which are particular to the Baltimore City and Maryland insurance markets, the Commission examined national trends related to loss costs and insurance premiums.

i. Bodily Injury Loss Costs

The most comprehensive study submitted to the Commission was a study completed by the Insurance Research Council (IRC) in February 1995 entitled "Trends in Auto Injury Claims: Second Edition" (hereinafter cited as the "1995 IRC report"). The IRC is a nonprofit research organization founded by the property-casualty insurance industry. This study examined those factors which influence loss cost and changes in those factors between 1980 and 1993. According to the 1995 IRC report, between 1980 and 1993, the average bodily injury claim payment grew 114%, from $4,755 to $10,587.[26]

ii. Claim Frequency

According to the 1995 IRC report, between 1980 and 1993 there was a growing tendency by Americans to file liability claims for injuries in automobile accidents. The number of bodily injury liability claims per 100 insured vehicles rose 33% during this period.[27] Interestingly, and paradoxically, although the frequency of bodily injury claims has been rising, the trend in accident rates is downward, according to the 1995 IRC report. One measure of the trend in

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[25] Id.

[26] 1995 IRC Report, p. 6.

[27] Id.

accident rates is to examine property damage liability claims. The incidence of such claims reflects the incidence of accidents because for every accident (in a tort state), the driver who is at fault is responsible for repairing all damaged property. In an accident where there is damage to a vehicle, a claim is made against the at-fault driver's property damage (PD) coverage. Therefore, the rate at which property damage claims are made reflects the underlying accident rate. The 1995 IRC report shows that between 1980 and 1993, although the frequency of bodily injury claims was rising, the frequency of property damage claims was falling.[28]

iii. Claim Severity

The severity of claims has also been growing in the period between 1980 and 1993. According to the 1995 IRC report, the average claim payment more than doubled under the bodily injury (BI), property damage (PD), and personal injury protection (PIP) coverages.[29] However, the average bodily injury claim payment rose slower than the medical component of the consumer price index. Thus, the average bodily injury claim payment was growing more slowly than medical costs, and the study concludes that "medical cost inflation alone isn't driving auto injury costs higher".[30]

iv. "Relative" Bodily Injury Claim Frequency

As noted above, claim frequency, the number of claims per 100 insured vehicles, varies between city and rural areas due to those factors particular to urban areas, such as vehicle density and traffic congestion. In order to compare the claiming frequency in rural and urban

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[28] 1995 IRC Report, at 7-8.

[29] 1995 IRC Report at 5-6.

[30] Id.

areas, the Commission examined the relative frequency of bodily injury claims. This measure, the number of bodily injury claims per 100 property damage claims, holds constant the variations in accident frequencies in rural and urban areas due to factors such as increased traffic density, and allows for comparisons between the number of BI claims per 100 PD claims in cities and in rural areas.

According to the 1995 IRC report, this particular measure of frequency shows a marked upward trend nationally:

> The number of bodily injury claims per 100 property damage claims increased 18% between 1989 and 1993 to 29.3 from 24.9, an average annual growth rate of 4.2 percent. Over the full 1980 to 1993 time horizon the number of bodily injury claims per 100 property damage claims increased 64%. In other words, given an accident, the likelihood of filing a bodily injury claim has increased 64%.[31]

Therefore, according to the 1995 IRC report, there is a national trend that for every accident in which property damage is claimed, there is an increased likelihood of a bodily injury claim being filed.

v. Differences In Relative Claim Frequency In Urban And Rural Areas

The national trend which is most relevant to the justifications offered by insurers for higher rates in Baltimore City are those trends comparing relative claiming rates in cities and rural areas. According to the 1995 IRC report:

> Cities tend to have a higher number of bodily injury claims per 100 property damage claims than do towns in rural areas in the same state, indicating that city residents are more likely to file an injury claim than are people in rural areas. There were 29.4 bodily injury claims per 100 property damage claims in Miami, highest in Florida, compared to 8.8 bodily injury claims per 100 property damage

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[31] 1995 IRC Report at 9.

claims in Franklin County, low for the state.[32]

Exhibit 6 (Figure 3-3 from the 1995 IRC report) illustrates the great disparity in relative claiming rates between urban and rural areas in several selected states.

The 1995 IRC report concludes that these differences in rural and urban relative claiming rates are attributable to the claiming behavior of urban accident victims:

> Examining data within a state gives some of the strongest evidence that claim behavior varies from area to area. Differences from state to state as noted above can be attributed to differences in state laws. Within a state, though, large differences in the number of bodily injury claims per 100 property damage claims strongly indicate differences in claiming behavior. Accidents in urban areas typically occur at low speeds, so should result in fewer bodily injury claims per 100 property damage claims. Yet urban areas have some of the highest numbers of bodily injury claims per 100 property damage claims.[33]

In examining the huge disparity in bodily injury rates per 100 insured vehicles in California, the report notes that "a person involved in an accident in Los Angeles was more than twice as likely to have a bodily injury claim payment as an accident victim in any of the other three cities, a clear sign of difference in claiming behavior."[34]

vi. Differences In Injuries And Treatments Received In Urban And Rural Areas

The relative claiming rate is not the only difference between rural and urban areas in the states. The Commission examined reports submitted by the insurance industry relating to the types of injuries reported by rural and urban claimants.

According to the 1995 IRC report, 75% of central city accident victims reported a sprain

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[32] 1995 IRC Report at 15.

[33] 1995 IRC Report at 16.

[34] 1995 IRC Report at 20.

or a strain, as compared to 51% of accident victims in rural settings.[35] While these "soft tissue" injuries are more prevalent in city settings, more serious injuries are more prevalent in rural settings. Four percent of central city accident victims reported fractures, while 12% of accident victims in rural settings reported fractures. Similarly, 1% of the claimants in central city settings reported permanent total disabilities or fatalities, while 5% of claimants in the rural areas were reporting permanent total disability or fatality. According to the report, claimants in central city settings were also less likely to have received no hospital treatment (53%) as compared to claimants in rural areas (25%).[36] These statistics corroborate the premise that urban accidents are less severe than those in more rural areas.[37] (As used in the cited studies and throughout this Preliminary Report, "soft-tissue" injury means sprains and strains that, unlike fractures or lacerations, are generally not objectively verifiable.)

The Commission has also reviewed a 1994 study entitled "Auto Injuries: Claiming Behavior and its Impact on Insurance Costs" conducted by the IRC (hereinafter cited as the 1994 IRC study) that examined variations in injuries to automobile accident victims depending on the location of the accident. This study corroborates the data in the 1995 Report concerning the types of injuries sustained by urban accident victims.

The 1994 IRC study found that in central city accident locations, 64% of the bodily injury claimants reported only sprains or strains, as compared to 40% of bodily injury claimants

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[35] 1995 IRC Report at 16.

[36] Id.

[37] Id.

in rural areas.[38] The 1994 IRC study further found that between 1977 and 1992, more claimants experienced no disability as a result of their injury and there was a decline in hospital admissions for those making bodily injury claimants from 16% in 1977 to 7% in 1992.[39] The 1994 IRC study reported similar trends with respect to PIP coverage. The percentage of PIP claimants reporting sprains and strains increased from 64% in 1987 to 71% in 1992. The number of PIP claimants that did not experience any disability related to their injury increased from 45% to 56% from the period 1977 to 1992, and PIP hospital admissions have declined from 18% in 1977 to 10% in 1992.[40] Trends relating to the care of PIP claimants by health care professionals track those trends described above relating to third-party claims.

vii. National Trends Relating To The Use Of Particular Health Care Providers.

The 1994 IRC study also examined national trends relating to the use of particular health care providers by automobile accident victims. The 1994 IRC study found there was an increase in the use of particular health care practitioners during the same period.[41] For bodily injury claimants, 27% of the claimants used chiropractors in 1992 compared with 20% in 1987.[42] Seventy percent used physical therapists in 1992 while 14% of bodily injury claimants used physical therapists in 1987.[43] In 1992, the average number of chiropractor visits was 25 for

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[38] IRC study, "Auto Injuries: Claiming Behavior and its Impact on Insurance Costs", September, 1994 (hereinafter cited as 1994 IRC Study") at 19.

[39] 1994 IRC Study, at 20-28.

[40] Id.

[41] Id.

[42] Id.

[43] Id.

bodily injury claimants, and the average number of physical therapist visits per bodily injury claimants was 19.[44] In contrast, the average number of visits by a bodily injury claimants to a physician or osteopath in other than an emergency room setting was 8.[45] Several conclusions can be drawn based on these statistics relating to types of injuries sustained and the type of provider most likely to render care. First, as noted above, generally urban accidents are less severe than rural accidents, and the types of injuries most frequently reported by urban accident victims supports this premise. Further, the increased usage by urban accident victims of providers who treat less severe injuries is consistent with the fact the victims of urban automobile accidents are less seriously injured. However, if urban accident victims are less seriously injured than those in other areas, one would expect the medical expenses of such victims, the economic losses, to be lower. The testimony and evidence was inconsistent on this point. The 1994 IRC data show that the average BI payment for chiropractor and physical therapists is $1,999 and $1,676 respectively, the highest among all providers in the study.[46] However, representatives of these providers presented testimony that care rendered by members of these professions is less costly than care rendered in other settings or by physicians.

viii. Attorney Involvement

1) Attorney Involvement As A Factor In Insurance Costs

The insurance industry argues that one of the significant factors contributing to insurance costs is the level of attorney involvement in automobile accident claims. In support of this

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[44] Id.

[45] Id.

[46] Id.

claim, the industry relies heavily on the data in the 1994 IRC study. The study concludes that high levels of attorney involvement in auto injury claims are associated with high auto insurance costs.[47] The study, which is based on a closed-claim study of over 62,000 claimants, attributes the high cost of attorney involvement to the fact that attorney-represented claimants report higher economic losses, such as medical expenses, than do claimants who are not represented by attorneys.[48] For example, Figure 6-9 from the study (Exhibit 7) shows that for claimants represented by an attorney and reporting a back sprain or strain, but who lost no time at work, economic loss was more than three times that of such claimants who were not represented by counsel. Similarly, for claimants represented by an attorney and reporting back strain or sprain but who were not restricted in the performance of their usual daily activities, economic loss was more than three times that of a claimant without representation.

There are several possible explanations for the dramatic differences in losses and injuries claimed by victims represented by lawyers and those who are not. The Institute for Civil Justice (ICJ), part of the RAND Domestic Research Division, identified the following possibilities:

> People who are more seriously injured or who incur greater losses are more likely to seek representation. Attorneys are more likely to take on a client whose injuries and losses are greater. Attorneys may encourage their clients to obtain the medical attention they need or, they may encourage their clients to obtain more medical attention than they need.[49]

At least one explanation posited by the ICJ, that only the more seriously injured victims are represented by counsel (and therefore the claims costs of such victims are higher because

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[47] 1994 IRC Study, at 58-59.

[48] 1994 IRC Study, at 64.

[49] Institute for Civil Justice (ICJ), "No-Fault Approaches to Compensating People Injured in Automobile Accidents", 1991, at 27.

their medical bills are higher), does not square with the data reviewed by the Commission. If this explanation were the sole reason for higher claims costs in attorney-represented cases, one would expect those states in which attorney representation is highest to also have the highest incidence of serious injuries. In examining the incidence of serious injuries among claimants in all the states, and the level of attorney involvement in automobile accident claims in the state, 1994 IRC study found that a particular state's rate of serious injury (defined as fatalities, brain injuries, bone fractures, loss of senses or internal organ injuries) did not correlate with that state's level of attorney representation.[50]

Furthermore, if the rate of attorney involvement correlated with the seriousness of the accident, one would expect a low level of attorney involvement in cities, because, as was noted earlier, city accidents are generally less serious, not more serious, than accidents in rural areas.

The 1994 IRC study asserts that the higher economic loss is due to more expensive medical care rendered to claimants represented by counsel.[51] Using the back-strained victim described above, who lost no time from work and was therefore presumed not to be seriously injured, the study in Figure 6-11 (Exhibit 8) shows little difference in the extent of hospitalization for such victims whether or not represented, but in Figure 6-12 (Exhibit 9), the study shows that attorney-represented victims are more likely to seek care on a non-emergency basis and are more likely to be treated by chiropractors and physical therapists.

Another of the explanations, that attorneys may encourage their clients to obtain more medical care than is needed, is a controversial one. Representatives of the trial bar are the first

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[50] IRC Study, at 58.

[51] 1994 IRC Study, at 65.

to agree that obtaining compensation for nonexistent injuries, or "building-up claims, is fraudulent and should be prosecuted. However, they deny there is widespread involvement by attorneys in any over-compensation of accident victims. Whether the medical care received by an attorney-represented accident victim is appropriate given the victim's injuries (another of the possibilities suggested in the ICJ report) or is excessive, is in many cases the distinction between proper treatment and insurance fraud. The subject of fraud and excessive treatment for injuries is discussed more fully in part B.4. of this Section.

2) Variation Of Attorney Involvement By Geography

The 1994 IRC study also suggests that attorney involvement in automobile injury claims varies widely by, but correlates with, accident location. The highest percentage of represented bodily injury claimants are found in central cities (64%) and their suburbs (63%). In rural areas, 49% of claimants were represented by attorneys.[52]

b. Maryland And Baltimore

The Commission considered testimony and material indicating that Maryland and Baltimore follow the national trends relating to automobile accident claims and those factors which increase automobile insurance costs, except that in many cases Maryland and Baltimore outpace those trends resulting in higher premiums than in other cities and states.

i. Bodily Injury Loss Costs

According to the 1995 IRC report, bodily injury loss costs in Maryland rank 13th highest among the states.[53] Although representatives of the trial bar argue that BI loss costs in

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[52] 1994 IRC Study at 46-47.

[53] 1995 IRC Report at 5.

Maryland are among the lowest in the nation, the data cited above do not support this conclusion.

While Maryland's BI loss costs may be high in relation to other states, the Commission also considered data relating to those factors which account for the great disparity of costs among territories within Maryland. Exhibit 5 examines loss costs for territories in Maryland established by Insurance Services Office (ISO) and shows that the average loss cost in Baltimore City is three times that of rural counties ($305.67 vs. $104.53). In addition, the Commission reviewed a report on relative loss costs by ISO. ISO examined 5 years of insurance data for 18 different cities and ranked these cities according to loss costs and claim frequencies relative to the State as a whole.[54] Baltimore consistently ranked high in these "relativities" as compared to such cities as Chicago, Miami, Newark, Boston and New York City. For example, the bodily injury liability loss cost for Baltimore City was 2.37, meaning BI loss costs in Baltimore City were 2.37 times BI liability loss costs in the rest of the State. In this measure, Baltimore ranked third highest, behind Newark and Philadelphia.

ii. Claim Frequency

There are several sources of data concerning the claiming frequency of specific territories in Maryland. The first is Maryland specific data in the 1995 IRC report. The second is data submitted by the Maryland Automobile Insurance Fund (MAIF). The third is data reported by ISO.

The 1995 IRC study provides an analysis of bodily injury and property damage claim frequency for the 50 states and for 9 Maryland territories. The data for the 9 Maryland

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[54] ISO, Inc., "Factors Affecting Urban Auto Insurance Costs", December, 1988.

territories are reproduced in Exhibit 5. Maryland ranks 13th among the states in terms of overall claims frequency. As for particular territories in the State, Territory 1, which is Baltimore City, has the highest claim frequency (number of bodily injury claims per 100 insured vehicles). Not only does Baltimore City have a high claim frequency relative to other territories in the State, the ISO data show that Baltimore City had the third highest frequency of the cities surveyed in that study.[55] Therefore, as with most cities, at least some of the higher costs of automobile insurance in Baltimore appear to be caused in part by the higher number of BI claims filed per 100 insured vehicles.

iii. "Relative" Bodily Injury Claim Frequency

An analysis of the 1995 IRC data on relative claiming rates, expressed as the number of bodily injury claims per 100 property damage claims, demonstrates that Baltimore's relative claim frequency exceeds that of other cities. For example, in Baltimore, there are 62.1 bodily injury claims for every 100 property damage claims. This far exceeds the relative claiming rate in such cities as Miami (29.4), Oakland (45.6) Pittsburgh (18.0), Cleveland (40.8) and Cincinnati (26.0).[56]

iv. Differences In Urban And Rural Areas

Maryland and Baltimore also reflect national trends reflecting a great disparity between urban and rural relative claim frequencies. As shown in Exhibit 5, the relative claiming rate in Baltimore City (Territory 1) is more than twice the rate than for such territories as suburban Montgomery County and Eastern Shore counties (Territories 8 and 13, respectively). This

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[55] Id. at 20.

[56] 1995 IRC Study, at 18.

means that for every accident that results in property damage for which a third-party claim is filed, it is twice as likely that a claim for bodily injury will also be filed in Baltimore City than in suburban or rural territories. This increases insurance rates for residents of Baltimore City as compared to residents of other jurisdictions.

The data submitted by MAIF also support the general proposition that bodily injury claims are more likely to be filed when an accident occurs with a Baltimore City at-fault insured, but the numbers suggest the problem is much worse among MAIF insureds. According to the MAIF data, the ratio of bodily injury claims to property damage claims is 113.8, meaning that for every accident that results in a third-party claim for property damage, there was at least one, and in many cases more than one, bodily injury third-party claim.[57]

v. Claim Severity

As discussed above, claim frequency is one component of the loss cost or pure premium; i.e., the basic "cost" of the product before factors such a general expenses and profit are added. The second is claim severity. The IRC data in Exhibit 5 shows that the claim severity in Baltimore City is the lowest of all territories reported, with an average cost of $8,422. The statewide average is $8,932, with the two highest being Prince George's County ($9,544) and Baltimore outer suburban ($9,520). The ISO report supports the IRC data. According to that study, Baltimore ranked the lowest among 18 cities in terms of relative BI liability claim severity at .84.[58]

It was suggested to the Commission that, given these data, claim severity does not play

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[57] Testimony and material submitted to the Commission by David C. Trageser, Executive Director, Maryland Automobile Insurance Fund.

[58] ISO, "Factors" at 10.

a role in the high rates in Baltimore City. However, claim severity is a measure of the average claim settlement cost per claim. It is computed by dividing the total dollars for all claims by the total number of claims for that coverage. Therefore, as the number of claims increases, the denominator in the calculation for claim severity increases and thus claim severity falls. Since the number of claims in Baltimore City is higher than other areas of the State, the relatively low claim severity would appear to reflect the relatively high number of claims in the City per insured vehicle, rather than a relatively low amount of dollars paid out in losses.

vi. Attorney Involvement

Just as Maryland and Baltimore are consistent with those characteristics described in the preceding Sections relating to BI loss costs, claim frequency, and relative claim frequency, Baltimore is consistent with, but exceeds, the national trends in terms of its level of attorney representation for BI claims. In Baltimore City, 89% of all bodily injury claimants were represented by an attorney.[59] This was the second highest attorney-representation percentage for a city in the nation, second only to central city Los Angeles (92%). Similarly, Baltimore had the highest PIP attorney-representation rate at 80% in central city.[60] The next highest city was Philadelphia with 77% and Washington, D.C. with 56%. The Washington, D.C. rate for attorney representation for BI claimants for the city itself was 76%. Maryland ranked highest among tort states for percentage of attorney involvement in BI claims at 74%. Pennsylvania was ranked second at 68%, and Virginia was sixth at 55%.

Several conclusions can be drawn from these data and data presented previously in this

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[59] 1994 IRC Study, at 48.

[60] Id.

Report relating to insurance costs in Baltimore City and attorney involvement. First, the data discussed in this Section show that attorney involvement in an automobile accident case substantially increases the claim cost of the accident, often by a factor of three. Baltimore has a high rate of attorney involvement compared to other jurisdictions in the State and to other cities. As a consequence, these data support the conclusion that attorney involvement plays a role in contributing to high rates in Baltimore City.

There was no evidence explaining the high rate of attorney involvement, although the high rate of attorney advertising on television in the State was cited as one possibility. Commission members noted, however, that television advertisements are seen by a wider audience than just Baltimore City. One possible explanation is that, as discussed previously, the likelihood of attorney involvement increases as the seriousness of the accident increases. However, there was no evidence to suggest the high rate of attorney involvement in the City is due to the possibility that City residents sustain more severe injuries in their accidents than residents in other cities. In fact, the testimony submitted suggests that because accidents in urban areas occur at lower speeds generally, one would expect fewer injuries in City accidents, and therefore no increased likelihood for attorney involvement.

3. Anatomy Of A Bodily Injury Claim

The Commission received and considered testimony describing the anatomy of a typical automobile accident in Maryland. The testimony was in part based on studies presented to the Commission, such as those discussed above, and in part based on anecdotal oral testimony by the trial bar and the insurance industry. The testimony was instructive as to the interaction of many of the issues discussed in this Report including claiming behavior by injured parties,

attorney involvement, claim settlement practices by insurers, required coverages, duplication of coverage, and utilization of health care providers.

As noted above, most claimants in automobile accidents in Baltimore City, and the rest of the State, are represented by counsel. Therefore, in the vast majority of automobile accident cases, either the claimant contacts an attorney or the attorney contacts the claimant. Once representation is established, the attorney opens 2 files in the case, a PIP file against the injured party's own insurer, and a third-party BI and PD liability file against the party alleged to be at fault.

Claimants then receive treatment for their alleged injuries. According to the 1994 IRC study, up to 30% of Maryland automobile accident claimants are referred to a particular health care provider by their attorney.[61] This is the highest referral rate in the country. Reasons for this high rate of referral may vary. It was suggested to the Commission that some claimants, lacking health insurance and having no family physician, may not know of a provider to see. However, the Commission also received testimony from the insurance industry suggesting that in some situations involving insurance fraud, such referrals are made by an attorney to a provider known by the attorney in order to ensure a more lengthy and expensive course of treatment than the injuries or alleged injury may merit, thereby increasing recovery. In any event, the typical automobile accident claim in the City is for soft-tissue injuries, such as sprains and strains. This is generally corroborated by a study conducted by MAIF, which indicated that for MAIF insureds, 93% of all PIP medical payments were for the treatment of soft-tissue injuries.

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[61] 1994 IRC Study, at 68.

As treatment is rendered, bills are generated. As noted in Section A.3., the medical bills in automobile accident cases may be submitted to several different sources for payment. The testimony suggests that initial visits to health care providers are usually paid for through the PIP coverage. The bills may be also submitted to a health insurance carrier, and, ultimately, the medical bills are part of the "special" or economic damages for which payment is sought from the at-fault third party. The testimony indicated that although health insurers may seek recovery of such payments from at-fault parties through subrogation, this is not always or easily done.

There was testimony that focused on the manner in which automobile accident cases are negotiated and settled by the parties, particularly as to the recovery for noneconomic damages such as pain and suffering. The third-party claim has several components: the property damage claim, if, for example, the injured party's car was damaged, the bodily injury damages such as medical bills, lost wages, and finally the so-called noneconomic damages, such as pain and suffering. The insurance industry testified that the noneconomic element of the settlement is generally based on some multiple of the "specials" such as the medical bills. Thus, for example, if a person incurred $3,000 in medical bills, a settlement in this accident would most probably include a payment for pain and suffering that could range anywhere from 1 to 4 times this amount, or an additional $3,000 to $12,000. The insurance industry also testified, however, that other factors affect the settlement amount, including the nature of the injury and its impact on the claimants daily living. The testimony of the insurance industry relating to the use of multiples of the "specials" to determine general damages was supported by several studies reviewed by the Commission. One study, prepared by the Institute for Civil Justice, found that for individuals with less than $2,000 in medical bills, total recoveries averaged 2.5 times their

economic loss.[62] A study prepared by Tillinghast, an independent actuarial firm, found that for every $1.00 of economic losses paid to injured parties in Maryland, those claimants that hired an attorney received an additional $1.57 in noneconomic losses.[63] The 1994 ICJ study suggested that in the case of less serious injuries, claimants with attorneys received $2.00 - $3.00 for each dollar of economic loss.[64]

Representatives of the trial bar testified that the use of formulas to determine pain and suffering was an innovation of the insurance industry to more easily allow for the settlement of cases without the need for a trial.

The testimony describing the typical automobile accident case raises several points of importance to the Commission. First, as noted in Section A, there are several opportunities for multiple recovery for a claimant's medical expenses in the system. For example, if health care visits are first paid for by a health insurer, the claimant may also recover payment from his or her PIP carrier. This is because the law requires that PIP payments are paid without regard to other sources of payment. In the case where PIP pays for the initial visits rather than a health insurer, the chances for double recovery are lessened since more health insurers will seek to coordinate benefits with the PIP carrier and avoid double payment. However, whether or not a claimant receives multiple first-party recoveries, the law permits the same bills to be submitted to the at-fault party for payment. Since these multiple recoveries are made in large part from BI and PIP coverages, these multiple recoveries add to the cost of automobile insurance

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[62] ICJ, "No-Fault Approaches to Compensating People Injured in Automobile Accidents", 1991.

[63] Tillinghast, "Governor's Commission on Insurance: Study of Private Passenger Automobile Liability Insurance System", November, 1990, at 37.

[64] 1994 IRC Study, at 62.

generally.

The second point of significance for the Commission is that, as noted in a 1995 report by the Institute for Civil Justice,[65] the current system of claimant compensation, which allows for double or even triple recovery of medical costs, and which compensates victims for pain and suffering based on a multiple of the actual damages sustained, coupled with the current system of attorney compensation wherein attorney's fees are linked to the size of the total recovery, creates the opportunity for some unscrupulous claimants, health care providers and attorneys to profit from over-treatment of injuries, or treatment for nonexistent injuries. Such conduct, which constitutes fraud and is discussed in more detail in the following Section, adds to the cost of automobile insurance because, again, payments for inflated or nonexistent injuries are made from BI and PIP coverages.

4. Insurance Fraud - Claims For Nonexistent Injuries And "Cost Build-Up"

Insurance fraud was cited by the insurance industry as a factor that increases insurance rates. One representative of the industry testified that up to 10% of claims involve "hardcore" fraud and up to 40% of claims involve inflated claims.[66]

The Commission considered a report addressing claiming behavior and fraud prepared by The Institute for Civil Justice (ICJ). The authors of the ICJ study developed a methodology for measuring the frequency of claims for nonexistent injuries, and for claims subject to "cost buildup," the two types of fraud that would be most common under Maryland's compensation system. The study used as a baseline the ratio of soft-injury claims to hard-injury claims in

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[65] Institute for Civil Justice (ICJ), "The Costs of Excess Medical Claims for Automobile Personal Injuries" 1995, at 5 (hereinafter cited as "ICJ, Excess Medical Claims".

[66] Testimony of David Snyder, American Insurance Association.

Michigan and New York, states with strong "verbal" no-fault thresholds.[67] The theory behind this methodology is that hard injuries such as loss of a limb or fracture, are objectively verifiable. It is difficult, or even impossible, to make a claim for a "hard injury" that in fact is nonexistent. That is not the case with soft injuries such as sprains or strains. Such injuries are not generally objectively verifiable and present an opportunity to exaggerate their existence or seriousness. However, in Michigan and New York, one would assume that claims for nonexistent soft injuries would be rarer because of the strong verbal threshold which prohibits third-party claims except for the most serious of injuries.[68]

Michigan and New York have a soft-injury/hard-injury index of .7; in other words, there are seven soft-injury claims for every 10 hard-injury claims. The authors of the study compared the extent to which the ratio of soft claims to hard claims in each state exceeds the corresponding ratio for Michigan and New York to measure the degree to which claims are being submitted for nonexistent soft injuries in that state. Under this methodology, Maryland had the second highest claiming rate for these so-called nonexistent injuries, second only to California.[69] Whether this ratio is a reliable measure of nonexistent claims was debated by Commission members. However, it does show that Maryland has the second highest percentage of soft-tissue injuries, compared to hard injuries, in the nation. See Exhibit 10.

The ICJ authors also studied the incidence of cost buildup on soft-injury claims. Maryland fared better in the ICJ study on this measure. Again, the study used Michigan and

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[67] ICJ, "Excess Medical Claims", at 13.

[68] Id.

[69] ICJ, "Excess Medical Claims, at 14.

New York to establish an index based on the assumption that there is little incentive to build up costs on soft-injury claims in Michigan and New York because of the strong verbal threshold. The study found that those states with no-fault laws with dollar thresholds were most susceptible to cost buildup in soft-tissue injuries. This finding supports what critics of such laws argue: the dollar threshold becomes a target for medical expenses, which, if exceeded, allows for recovery of pain and suffering. Maryland as an add-on state, was between Michigan and New York in this measure, and thus did not register as a state particularly susceptible to cost buildup.

The testimony before the Commission by representatives of the chiropractic profession was that claims for nonexistent injuries could be detected in many cases by thorough examinations by well-trained professionals. However, the representatives conceded that because of the subjective nature of soft-tissue injuries, fraud does occur.

In many respects, the General Assembly has already taken steps to address the issue of insurance fraud and its impact on rates. However, the Commission believes that even the most aggressive of fraud detection efforts will not prevent all fraud. The subjective nature of soft-tissue injuries makes detection of such fraud difficult, and the proof of such fraud in a criminal case particularly difficult. Consequently, the Commission believes that the efforts of the Insurance Fraud Division can be complemented with changes to Maryland's compensation system that reduce the incentives to commit fraud.

5. No-Fault Insurance

In a tort system, those individuals injured in an automobile accident seek recovery from other individuals, third parties, who may be liable to compensate them for their injuries. Recovery in the tort system would include compensation for economic losses, such as medical

costs and expenses, lost wages, and other monetary costs, as well as what are termed "noneconomic losses," which generally include compensation for pain and suffering and other nonmonetary damage. Under the traditional tort system, which is a fault-based system, the injured party will seek compensation from those third parties who are, or are claimed to be, responsible for the injured party's injuries. If the party at fault has automobile insurance, that person's bodily injury (BI) insurance pays the compensation the at-fault person owes to the injured person up to the limits of the policy.

Under a no-fault system, compensation for certain injuries is obtained from the injured party's own insurer, so-called first-party coverage, without regard to fault. In general, a no-fault insurance system will bar fault-based third-party liability claims unless the injury sustained by the injured party is sufficiently serious so that the law allows a third-party claim as well as the first-party claim against the injured party's own insurer. No-fault laws all have some type of "threshold" which will determine under which circumstances an injured party may bring a law suit against the at-fault party. Three states, Florida, Michigan, and New York, have a so-called "verbal threshold" which describes in words (e.g. "significant and permanent loss of an important bodily function") when a person's injuries exceed the "threshold" and therefore when that person may sue the at-fault party. Other state laws contain a so-called "dollar threshold" which permits an injured party to sue a third-party tortfeasor if the medical costs and other damages of the injured party exceed a specified dollar amount. By exceeding the threshold, an injured party in a no-fault state can sue for all economic loss above that which that injured party's own PIP coverage will cover, as well as any noneconomic losses such as pain and suffering, since those are not covered under the first-party PIP coverage.

The Institute for Civil Justice at RAND Corporation conducted an exhaustive study of no-fault in 1991 entitled, "No-Fault Approaches to Compensating People Injured in Automobile Accidents. "The study was based on a closed-claim industry survey conducted by the All Industry Research Advisory Council (AIRAC), currently called the Insurance Research Council (IRC). That study made a comparison of the gross and net compensation received by claimants in tort and no-fault states, as well as the relative "transaction cost," such as claims processing and attorneys' fees.

In tort states, the gross compensation paid to people injured in automobile accidents averaged $4,681.[70] Of this, claimants netted an average of $3,645, with $1,036 going to legal fees and other transaction costs. RAND used a simulated model to estimate the total compensation the average individual should have received, and the transaction costs, under a no-fault plan with a strong verbal threshold and a $15,000 PIP benefit level. Because the transaction costs were significantly reduced under the no-fault alternative, claimants took home a much greater percentage of the gross compensation as net compensation. The average gross compensation was $3,764, and the net compensation for the claimant was $3,182, or 85% of the gross compensation.[71] Insurer transaction costs were similarly reduced under the no-fault alternative. However, the reduction in transaction costs comes at a price: the net compensation to the claimant in the no-fault system is less than the net compensation a claimant receives in the traditional tort system.

The numbers described above are given assumptions about the particular no-fault plan;

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[70] ICJ "No-Fault Approaches to Compensating People Injured in Automobile Accidents". 1991, at 18-25.

[71] Id.

i.e., a strong verbal threshold and a $15,000 PIP benefit level. The specific results may vary depending on the actual design of the no-fault plan. In general, transaction costs account for about one-third of injury coverage costs in the tort system and a no-fault approach could reduce these transaction costs by about a third, resulting in an overall net reduction in total injury coverage costs of about 10 percent.[72] However, as described above, such reductions can mean reductions in compensation paid to claimants as well. Such a result can be expected based on the fundamental differences between a no-fault and tort system. Shifting from a tort system to a no-fault system means that injured people recover from first-party sources; i.e., their own insurer, rather than their third-party compensation sources. First-party sources, however, can only compensate for economic losses. Therefore, the reductions in net compensation to no-fault claimants generally are for noneconomic losses. The study concludes, in fact, that in general economic losses are generally more fairly compensated under a no-fault system than under a tort system.

Given the Commission's charge, the issue of particular concern to the Commission is whether no-fault insurance would serve to significantly reduce automobile insurance premiums for the City of Baltimore or the rest of the State. A number of studies have been conducted on this issue, and although the data suggest that there may be some savings attributable to no-fault insurance, the data in the reports are not conclusive. For example, the Research Division of the Maryland Department of Legislative Reference published a study in December 1990 entitled "No Fault Auto Insurance: Does it Provide Consumers More Benefits at a Lower Cost?" The report used a multiple regression analysis to examine the relationship between average premiums,

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[72] Id.

average losses, and no-fault insurance in various states. Among the benefits identified were the fact that many of the benefits associated with no-fault insurance are paid faster and that no-fault claimants receive a greater percentage of the total compensation. However, the report also concluded:

> The current 'in-balance' no-fault systems do not provide these benefits at a lower cost. Between 1984 and 1989, the average auto insurance premium in tort states was lower than in "in balance" no-fault states ($365.06 vs. $288.29). A multiple regression analysis revealed that the option of an "in balance" no-fault system increases average auto insurance premiums by $26.80.[73]

The insurance industry argues that an alternative to the traditional no-fault plan is the so-called "choice" no-fault proposal in which a consumer may choose either a traditional tort-based auto insurance plan or a no-fault plan. The industry cites a research brief prepared by the Institute for Civil Justice which suggests Maryland consumers would save on the average of 38% in premium costs if a choice no-fault plan were enacted.[74] However, the plan analyzed by the ICJ is an "absolute" no-fault plan in which "motorists may never sue, or be sued, for noneconomic damages."[75] The Commission notes that no state has ever enacted an absolute restriction on a claimant's ability to seek redress through the courts. As noted above, although such savings result in part from a reduction in transaction costs, the savings are also the result of lesser compensation being paid to accident victims.

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[73] Dr. Elizabeth Sammis, Maryland Department of Legislative Reference, "No Fault Insurance - Does It Provide Consumers More Benefits", 1990, at 14.

[74] Institute for Civil Justice (ICJ) Research Brief, "Choosing an Alternative to Tort", July, 1995.

[75] Id.

FINDINGS:

1. Bodily injury loss costs are a major contributing factor to insurance rates. These loss costs are in turn influenced by claim severity and claim frequency. In general, urban areas have higher claims frequency, and thus higher insurance premiums.

2. Urban areas generally reflect a higher "relative" claim frequency, the number of BI claims per 100 PD claims. This measure allows for a comparison between rural and urban areas, controlling for variations in those factors that affect frequency such as traffic congestion. Urban areas in general have higher relative claim frequencies. This higher relative claim frequency is most likely attributable to differences in claiming behavior among urban accident victims. That is, it is more likely that accidents in urban areas will result in a bodily injury claim being filed. This increases BI loss costs, which in turn increases premiums.

3. There is a correlation between attorney involvement in automobile accident cases and the economic losses reported by accident victims, with higher losses reported by claimants with attorneys. Urban accident victims are more likely to be represented by an attorney. Therefore, urban accident victims are more likely to report higher economic losses.

4. Urban accident victims are more likely to claim soft-tissue injuries than rural accident victims.

5. Insurance fraud contributes to insurance costs. Insurance fraud can take the form of claims for nonexistent injuries, and claims buildup. With respect to the former type of fraud, some data suggest Maryland has a high rate of claims for nonexistent injuries. With respect to the latter type of fraud, some data suggest that Maryland does not have a high rate of claims buildup.

6. Maryland and Baltimore track several national trends relating to automobile accident claims and factors that influence premium costs. However, in many cases those factors are more prevalent in Maryland and Baltimore.

7. Baltimore City has higher bodily injury loss costs than other areas of the State. Baltimore City has a greater claim frequency than any other area of the State. Some data show Baltimore has a high rate of claim frequency even compared to other cities. More frequent claims result in higher loss costs in Baltimore City. This contributes to high automobile insurance premiums in Baltimore City.

8. The frequency of claims for bodily injury filed for every 100 property damage claims resulting from an automobile accident in Baltimore City, the relative claim frequency, is more than twice that of suburban or rural parts of the State. This means that for every accident in which a property damage claim is filed, it is twice as likely that a bodily injury claim will be filed if the accident occurs in Baltimore City than in other areas of the State. The same holds true for PIP claims. The higher claim rate appears to be a function of claimant behavior.

9. Among tort and add-on states, Maryland ranks highest for the level of attorney involvement in BI claims arising out of automobile accidents. Baltimore ranks second highest among cities for the level of attorney involvement in BI claims arising out of automobile accidents. Because there is a correlation between attorney involvement and higher loss costs, the high level of attorney involvement in Baltimore City is a factor in Baltimore City's high insurance rates.

10. Maryland ranks highest in the nation of those claimants who were represented by attorneys who were advised by their attorney to see a particular health care provider.

11. The current system creates incentives for fraud in the treatment of injuries sustained in automobile accidents, which increases insurance costs and premiums, for the following reasons:

a. Claimants are compensated for noneconomic damages based on a multiple of the economic damages sustained by the injured party, and therefore increase their recovery for pain and suffering, and thus their total recovery, by increasing their special damages;

b. Because treatment for injuries covered by a person's PIP benefits are subject to multiple recoveries, each dollar spent on treating an injury covered by PIP increases the claimants overall recovery; and

c. Attorneys are typically compensated on a contingency fee basis, and therefore attorney's fees increase as special damages, and the corresponding general damages, increase.

These incentives may influence the claiming behavior of urban accident victims described in Finding No. 7 above.

12. No-fault automobile insurance laws, if adopted in the proper form, have the potential to reduce premiums in Baltimore City and the rest of the State. The data relating to actual premium reductions for no-fault laws that have passed are inconclusive. In general, any reductions in premiums would be partially the result of reduced recoveries by claimants, particularly for noneconomic damages.

SECTION D. AUTOMOBILE INSURANCE MARKET PRACTICES

The Commission reviewed the automobile insurance market in Baltimore City to determine the extent to which current market practices contribute to the high rate of automobile insurance in Baltimore City. In large part this testimony was similar to that considered by the General Assembly during the passage of House Bill 923 (1995).

1. Market System

As is the case in the rest of the State, there are three automobile insurance markets in Baltimore City: standard, non- (or sub-) standard and residual. The standard market, which is most attractive to private insurers, consists of drivers who are "good" risks, those with clean driving records. The non- (or sub-) standard market, which is currently serviced by both private insurers and the Maryland Automobile Insurance Fund (MAIF), consists of drivers who are not particularly good risks but are still insurable. The residual market, which MAIF was created to serve when Maryland adopted mandatory automobile insurance, consists of drivers who are such bad risks that they are uninsurable in the private market.[76]

House Bill 923 (1995) was proposed by the Governor and enacted by the General Assembly to stimulate the standard and non- (or sub-) standard markets in Baltimore City by requiring private insurers to submit and implement marketing plans in Baltimore City and to market their products in the same manner in the City as in the rest of the State. It was also designed to move good risks away from MAIF and into the standard market.

2. Private Insurers And Agents

The Commission received testimony that some private insurers and the agents who sell

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[76] § 243B(a), Article 48A, Md. Ann. Code.

their products are not as aggressive in Baltimore City as in other locations.[77] There was discussion among Commission members as to whether this was based on racial discrimination, particularly in the placement of agents by insurers. Representatives of the insurance industry strongly denied the suggestion of racial discrimination[78], and assert their marketing efforts are appropriate and designed to serve drivers in Baltimore City.[79]

3. MAIF And MAIF Producers

Although designed to serve the residual market only, MAIF has become active in the non- (or sub-) standard market, particularly in Baltimore City. One reason suggested for this, at least in part, has been the unwillingness of the private industry to solicit in Baltimore City. However, industry representatives testified that the private industry has been successful in "depopulating" MAIF by offering insurance to consumers who previously would have been insured by MAIF.[80] However, these representatives claim that the insurers who serve the standard and non- (or sub-) standard markets are limited in their ability to expand in the City because MAIF has subsidized rates in Baltimore City. While this has had the beneficial effect of holding rates down in Baltimore City in the non- (or sub-) standard and residual markets, it has also inhibited private insurers from competing on the basis of rates in the non- (or sub-) standard market. Two important public policy issues, therefore, are: 1) should MAIF be permitted to subsidize rates? and 2) should MAIF be permitted to write in the non- (or sub-) standard market?

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77 R&B Unlimited, Inc., "Underlying Risk Considerations", at 4-5 through 4-7.

78 Testimony of Marta Harting, Attorney for State Farm, May 8, 1995.

79 Id., and testimony of Scott W. Zeigler, Progressive Northern Insurance Company.

80 Testimony of Henry H. Stansbury, May 8, 1995.

MAIF accepts business through independent agents or brokers known as "MAIF producers". The Commission heard testimony that suggests that some MAIF producers engage in certain practices that contribute to the high rate of automobile insurance in Baltimore City, specifically by selling unnecessary but expensive additional coverages ("add-ons") and by financing insurance premiums, through wholly-owned subsidiaries, at excessive interest rates, sometimes exceeding 35% per annum. It was suggested that only MAIF be permitted to provide add-on coverages to MAIF drivers and that only MAIF be permitted to finance MAIF premiums. The MAIF producers and the premium finance companies that finance MAIF premiums provided testimony disputing these allegations and suggesting in particular with respect to premium financing that MAIF would be unable to finance premiums as efficiently or effectively as the private sector.[81]

FINDINGS

1. The private insurance industry is not servicing the standard and non- (or sub-) standard markets in Baltimore City as well as in other jurisdictions.

2. MAIF has been forced by market failure to service the non- (or sub-) standard market as well as the residual market in Baltimore City.

3. MAIF is making it difficult for private insurance companies to compete in the non- (or sub-) standard market in Baltimore City because MAIF is not charging adequate rates in Baltimore City.

4. MAIF drivers often unknowingly purchase unnecessary add-on coverages from MAIF producers in Baltimore City.

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[81] Testimony of Joseph A. Schwartz, III, Attorney for the Maryland Insurance Council, May 15, 1995 and June 6, 1995.

PART II

RECOMMENDATIONS

SECTION A. GENERAL DISCUSSION

There are two groups of consumers affected by automobile insurance reform: those who purchase automobile insurance and those who suffer injuries in automobile accidents. The former are insureds; the latter are claimants. The purpose of the Commission is to develop recommendations to reduce the cost of automobile insurance for insureds in Baltimore City without depriving claimants adequate compensation for bodily injury and property damage arising out of automobile accidents in which the claimants are not at fault.

To achieve this purpose, the Commission is proposing a series of recommendations to the Governor that require legislative action. Although the purpose of the Commission is to reduce rates in Baltimore City, its recommendations are statewide so that all residents of the State may benefit from reduced automobile insurance costs.

The Commission's legislative recommendations fall into two broad categories: (i) those that reduce the cost of automobile insurance by reducing the underlying loss costs covered by automobile insurance, and (ii) those that reduce the cost of automobile insurance by eliminating mandatory coverages. The former recommendations are the more meaningful because they reduce insurance costs without reducing coverage. It is, therefore, the Commission's hope that the recommendations relating to underlying loss costs will reduce the average cost of automobile insurance in Baltimore City by at least **20%**. This goal was selected because, in the opinion of the Commission, it is meaningful and achievable. The recommendations relating to the elimination of mandatory coverages would then give the automobile insurance consumer in

Baltimore City and elsewhere the option of reducing automobile insurance costs even more by foregoing certain duplicative or unwanted coverages.

The Commission has decided not to make legislative recommendations in three general areas. First, the Commission does not recommend that the General Assembly eliminate or modify territorial rating by insurance companies. Arbitrarily shifting automobile insurance costs from Baltimore City to other jurisdictions for the sole purpose of lowering premiums in Baltimore City is neither fair nor politically feasible. Second, the Commission does not recommend that the General Assembly adopt a no-fault system for compensating accident victims. While the evidence suggests that a pure no-fault system will reduce the underlying loss costs covered by automobile insurance, no state has yet adopted a pure system. In light of the history of no-fault proposals in Maryland, it appears unlikely that a no-fault system capable of reducing costs would be enacted by the General Assembly. Indeed, a no-fault system capable of being enacted by the General Assembly may actually increase costs. Some states have adopted or are considering "choice" no-fault in which each insured decides whether to remain within the current tort system or opt into a no-fault system. While the merits of consumer choice are obvious and while in theory a "choice" system produces substantial savings, it is not apparent to the Commission, in light of past legislative history, that a "choice" system capable of being enacted by the General Assembly will produce greater savings than can be produced by the recommendations set forth in this Report. The "choice" no-fault plan for which the Institute for Civil Justice recently reported significant savings was one in which all access to the courts was denied to those persons who chose no-fault, a concept the General Assembly is unlikely to embrace. Moreover, some of the cost savings attributable to any no-fault system are

achieved at the expense of accident victims, who may receive less than a full recovery because of limited access to the court system. Third, the Commission makes no additional recommendations regarding market reform. The reforms initiated by the Governor and enacted by the General Assembly in House Bill 923 (1995) should be given an opportunity to work before more reforms are instituted. Moreover, any decision to reform MAIF or the residual market should await implementation of the recommendations contained in this Report to reduce underlying costs. Otherwise the risk exists that automobile insurance costs in Baltimore City will increase if the role of MAIF is modified prematurely.

Of all the areas investigated by the Commission, fraud evoked the clearest response. **There is no room in the system for fraud.** Fraud must be rooted out aggressively and completely. In House Bill 923 (1995) the Governor and the General Assembly commenced the process by strengthening the Insurance Fraud Division. However, the system still requires greater enforcement efforts, particularly by the Attorney Grievance Commission and the several health care provider licensing and disciplinary boards. In addition, the opportunities for committing fraud must be reduced. Many of the Commission's recommendations are intended to tighten enforcement and limit opportunities so that the costs associated with insurance fraud can be greatly reduced, if not eliminated entirely.

Race was the most troubling and difficult issue which the Commission had to confront. The Commission received no credible evidence that automobile insurance rates are excessively high in Baltimore City because of intentional race discrimination by the insurance industry. The Commission did receive evidence to suggest a possible correlation between the racial composition of rating territories and automobile insurance rates. The Commission cannot ignore

the possibility that the territorial rating practices of some insurance companies may have a disproportionate impact on African-Americans in Baltimore City and perhaps in other areas of the State.

The Commission believes that the General Assembly has given the Insurance Commissioner broad and sufficient authority to prohibit, prevent and eliminate race discrimination in insurance. The Commission also believes that the Insurance Commissioner has the authority to examine and to regulate the territorial rating practices of insurers within the framework established by the General Assembly. Although, in the past, the Maryland Insurance Administration (MIA) has been diligent in ensuring that rates within each territory are actuarially justified, less regulatory attention has been given the justification or rationale for the way in which particular rating territories are established and their boundaries drawn.

The Commission notes that the Insurance Code prohibits rates from being "based partially or entirely on geographic area itself, as opposed to [being based on] underlying risk considerations, even though expressed in geographic terms." The Commission recommends that the Maryland Insurance Administration (MIA) adopt regulations to define the "underlying risk considerations" that may be used by insurance companies in establishing or applying rating territories. The Commission also recommends that the Maryland Insurance Administration (MIA) investigate the relationship between the racial composition of rating territories and automobile insurance rates and, if appropriate, adopt regulations that will ameliorate the impact of territorial rating on African-Americans in Baltimore City and elsewhere without arbitrarily shifting automobile insurance costs from one territory to another.

In making its recommendations, the Commission wishes to stress the importance of and

need for consumer education. House Bill 923 (1995) required the Insurance Commissioner to establish a toll-free telephone number to assist and educate consumers on automobile insurance, providing callers educational materials such as a rate guide or other list of agents and insurers. It is clear from the testimony received by the Commission that even more is needed. Many insurance consumers in Baltimore City simply do not know where to go to get the lowest rates. They are not aware of all their options. Although the Commission does not make any specific recommendations on consumer education, it encourages grass-root community organizations to focus their efforts on educating the drivers in their community -- providing information about alternatives, how to "shop around", how their own behavior influences risk (and therefore cost) and how fraudulent behavior impacts rates. In the end, public education may be even more effective than legislation or regulation in addressing the high cost of automobile insurance in Baltimore City.

Finally, the Commission urges the Governor to be vigilant in ensuring that any cost-savings achieved by the Commission's recommendations be passed on to consumers in the form of lower rates. All of the Commission's work will go for naught if the only result is to increase the profitability of insurance companies.

SECTION B. SPECIFIC RECOMMENDATIONS

Based upon the findings set forth in Part I of this Report, the Commission recommends the following:

1. **Legislation To Eliminate Multiple Recoveries For The Same Injury**

a. Personal injury protection (PIP) benefits may be paid only to reimburse the insured for expenses not otherwise covered by health or disability benefits.

Explanation and justification: The Commission received testimony that the majority of PIP benefits are paid for medical expenses, and therefore PIP duplicates the function of health insurance for those who have it. This recommendation mandates a coordination of benefits with applicable health and disability insurance, and requires that any PIP premium be reduced to reflect the secondary nature of PIP. Current law authorizes, but does not require, the coordination of benefits between a PIP carrier and health and disability insurers. The testimony before the Commission was that when such coordination occurs, generally PIP remains primary and it is therefore the health insurance premium, not the auto insurance premium, that is reduced.

b. Uninsured motorist (UM) benefits must be reduced by compensation paid or payable from collateral sources.

Explanation and justification: The Commission found that uninsured motorist (UM) coverage compensates victims for damages, including lost wages, medical expenses, resulting from an accident with an uninsured vehicle. Current law permits recovery of such damages from other collateral sources, which results in higher UM premiums that would be if UM benefits were reduced by collateral sources.

c. Recoveries from third-party liability insurers and judgments on third-party claims must be reduced by compensation paid or payable from collateral sources.

Explanation and justification: The Commission found that Maryland's current system of compensation allows automobile accident claimants to receive PIP benefits from their automobile insurance policies, and in some cases health insurance benefits from the claimant's health insurer, and then to recover all injury related expenses in any third-party claim against an at-fault driver. The PIP statute expressly prohibits a PIP carrier from pursuing a right of subrogation against the at-fault party to recover the duplicative benefits. Although the law does permit health insurers to recover payments made through subrogation, the testimony was that this was not always done.

This practice of allowing recovery from multiple sources increases insurance premiums system wide. While an insured may voluntarily choose to pay two separate premiums to separate insurers in return for the right to recover duplicative benefits, the Commission does not believe there is any entitlement to recover benefits from a third-party carrier, to whom the injured party has paid no premiums, for damages that have already been compensated. While this practice puts dollars in the pockets of one set of consumers, claimants, it does so at the direct expense of the other group of consumers, those who purchase automobile insurance.

If third-party claims were reduced by sums recovered by just one collateral source, PIP, then each third-party claim payment in which PIP were applicable, would be reduced by up to $2,500.00. Thus, reducing double recovery should substantially reduce the part of the premium identified by the Commission as the largest cost component of the overall premium, the portion attributable to bodily injury (BI) coverage.

2. Legislation To Reduce Medical Costs And Attorney Involvement In Bodily Injury Claims

a. **Insurers may offer personal injury protection (PIP) with a managed-care option; major insurers and the Maryland Automobile Insurance Fund (MAIF) must offer personal injury protection (PIP) with a managed-care option for soft-tissue injuries.**

Explanation and justification: The Commission found Maryland's system for compensating accident victims creates opportunities and incentives for unscrupulous claimants, attorneys and health care providers to over-treat injuries, or treat non-existent injuries, in order to maximize recoveries. While representatives of all groups deplored such conduct, all conceded that there is the potential and the practice of such conduct. While the Commission agrees that such conduct is fraudulent and should be prosecuted, the testimony also indicated that the subjective nature of soft-tissue injuries makes such conduct difficult in some cases to identify, and hard to prove by criminal standards.

One method to reduce any opportunity for over-treatment of injuries is to require, at least for major insurers, that PIP benefits for the treatment of soft-tissue injuries be delivered in a managed-care setting. Under this recommendation, the PIP carrier or a managed-care entity with whom the PIP carrier could contact, would limit the over-utilization that can occur under the current system. Because the coverage is optional, an insured who wanted the freedom to pursue his or her own course of medical treatment could do so by opting for standard PIP coverage. The Commission received testimony that other states, particularly New York and Colorado, have provided for managed-care PIP, and that substantial savings are attainable under this approach.

b. i. **Health care providers may not charge more for the treatment of soft-tissue injuries arising from automobile accidents than would be reimbursed by Medicare.**

ii. **Third-party defendants may not be liable for medical costs associated with the treatment of soft-tissue injuries arising from automobile accidents in an amount greater than would be reimbursed by Medicare.**

iii. **Third-party defendants may not be liable for medical costs associated with the treatment of soft-tissue injuries arising from automobile accidents if a peer review organization determines that the treatment fails to conform to professional standards of performance or is medically unnecessary.**

Explanation and justification: Because of the incentives for over-treatment and fraud inherent in Maryland's automobile accident compensation system described in recommendation 2.a., the Commission recommends that additional steps be taken to limit unnecessary and excessive claims. The Commission received testimony that these recommendations, which limit the fees paid to providers who treat soft-tissue injuries arising out of automobile accidents and provide for peer review of medical treatments to accident victims, have successfully reduced automobile insurance premiums in Pennsylvania.

c. **Attorneys may not send targeted direct-mail solicitations to automobile accident victims or their relatives for 30 days following an accident.**

Explanation and justification: The Commission found that Maryland in general and Baltimore City in particular have one of the highest rates of attorney involvement for automobile accident cases in the country. Furthermore, the Commission found that Maryland

has the highest rate of attorney's recommending to claimants particular health care providers. Finally, the Commission found that Baltimore City has one of the highest rates of BI claims per 100 PD claims in the nation, and also leads the nation in certain statistics concerning potentially fraudulent claims. While a cause and effect relationship between the rate of attorney involvement and the other factors listed is difficult to establish because other factors such as claimant behavior influence the high rate of claims filed, the Commission found there is a correlation between the high rate of attorney involvement and the high rate of BI claims in Maryland and Baltimore. Consequently, the Commission believes a thirty-day waiting period for direct-mail solicitations by attorneys to automobile accident victims, such as that adopted in Florida and recently held constitutional by the Supreme Court, is a reasonable measure to counterbalance the relatively large role attorneys play in the claiming process in Maryland.

3. Legislation To Reduce Insurance Fraud

a. An insured may not recover uninsured motorist (UM) benefits without physical evidence of contact between the insured's vehicle and the hit-and-run vehicle.

Explanation and justification: The Commission found that UM coverage is particularly susceptible to abuse and fraud. Insureds who accidently cause damage to their own vehicle may claim the damage was caused by a hit-and-run or "phantom" vehicle, and collect under their UM coverage. This practice increases payments under UM coverage, and thus increases the cost of UM insurance to all consumers of automobile insurance. The so-called "contact rule" helps to reduce unnecessary and fraudulent UM payments.

b. An accident reporting unit shall be established within the Baltimore City police department as a pilot program, staffed by non-police personnel and funded by

the insurance industry, to prepare written accident reports at the accident scene.

Explanation and justification: The Commission received testimony that unless an automobile accident is reported to involve serious bodily injury, local or state police may not, and typically do not, respond to the scene of the accident. While the need for over-worked police units to prioritize calls is understandable, the lack of a police report from an accident scene creates the opportunity for insurance fraud. Without a credible report taken at the scene of the accident concerning the number of victims, automobiles, and other pertinent data, the potential exists for the number of claimants, and the nature of injuries, to be exaggerated. Because the benefits of a dedicated accident reporting unit, relative to its costs, cannot be accurately predicted, a pilot program limited initially to Baltimore City is a positive first step.

c. i. The Insurance Fraud Division must refer evidence of attorney or health care provider fraud to the appropriate licensing and disciplinary boards.

ii. Attorney and health care provider licensing boards must report to the Insurance Fraud Division on any case referred to them by the Division in which disciplinary action is not taken and the reasons why disciplinary action was not taken.

iii. The license of any attorney or health care provider convicted of insurance fraud must be revoked.

Explanation and justification: The Commission found that witnesses representing attorneys and health care providers before the Commission denounced any fraudulent conduct that may occur in a small segment of the professional population. However, under current practice, evidence of fraud on the part of these professionals is not always referred to the appropriate professional licensing board for disciplinary action and disciplinary action is not

always taken.

d. A person may not pay or receive compensation for directing or referring an automobile accident victim to an attorney or health care provider.

Explanation and justification: The Commission received vivid testimony from a state police fraud investigator regarding practices used by certain attorneys and health care providers to attract customers. No one condones the use of paid "runners" to direct accident victims to particular attorneys or clinics. Arizona and Georgia have adopted laws to prohibit this practice.

e. i. Before a claim has been made, an insurer may cancel and rescind an insurance policy immediately and without prior notice if the insured makes misrepresentations in the application for automobile insurance and the insurer would not have issued the policy if the true facts had been made known to the insurer as required by the application.

ii. After a claim has been made, an insurer may deny first-party benefits to an insured who makes misrepresentations in the application for automobile insurance if the insurer would not have issued the policy if the true facts had been made known to the insurer as required by the application.

Explanation and justification: If a person procures insurance fraudulently, the cost of that fraud is borne by the drivers who procured their insurance honestly. The only way effectively to limit this cost-shift is to permit insurers immediately and without prior notice to cancel and rescind the policy if the fraud is discovered before a claim is made and to deny first-party benefits to the fraudulent party if the fraud is discovered after a claim is made.

4. Legislation To Reduce The Number Of Mandatory Coverages

a. **Insurers must make personal injury protection (PIP) available to all insureds; an insured does not have to purchase personal injury protection (PIP).**

Explanation and justification: The Commission found that even when waived by the named insured, PIP still constitutes a substantial portion of the automobile premium because the "waived" PIP coverage still applies to passengers and pedestrians. For some MAIF insureds in Baltimore City, this may be as much as $190.00. Requiring that PIP, when waived, be waived as to all persons does not restrict the ability of passengers or pedestrians to make claims under their own PIP coverage, or to make third-party claims against at-fault parties if there is no PIP coverage available to them.

b. i. **Insurers must make uninsured motorist (UM) coverage available to all insureds; an insured does not have to purchase uninsured motorist (UM) coverage.**

ii. **An insured who does not purchase uninsured motorist (UM) coverage may not claim against the Unsatisfied Claim and Judgment Fund.**

Explanation and justification: The Commission found uninsured motorist (UM) coverage is a mandated first-party coverage that compensates insureds for bodily injury and property damage caused by at-fault uninsured drivers or phantom or hit-and-run vehicles. Much of the protection provided by UM coverage may be provided from other sources. For example, medical bills resulting from an accident caused by an uninsured motorist may be paid by the victim's health insurance, or the insured's PIP coverage if he or she has not waived PIP. Lost wages up to $2,500.00 may be paid by PIP as well. With respect to property damage (PD) coverage, as noted in the report, the UM statute is vague as to whether it was originally intended

to cover property damage, and, as described above, this coverage is susceptible to fraudulent claims. Claimants should have the option of purchasing coverage that serves to mainly protect the value of their own vehicle.

Therefore, the Commission believes insureds should have the same choice with respect to UM coverage as insureds currently have with respect to the other mandatory first-party coverage, PIP.

5. Regulation Of Territorial Rating Practices

a. The Maryland Insurance Administration (MIA) should adopt regulations to define the "underlying risk considerations" that automobile insurers may use in establishing or applying rating territories.

b. The Maryland Insurance Administration (MIA) should

i. investigate the relationship between the racial composition of rating territories used by insurance companies and automobile insurance rates; and

ii. if appropriate, adopt regulations to ameliorate the impact of territorial rating practices on African-Americans in Baltimore City and elsewhere without arbitrarily shifting automobile insurance costs from one territory to another.

Explanation and justification: The Commission examined the rating practices of insurers and the law regulating those practices. The law authorizes insurers to express rates in geographic terms, so long as those rates are based on "underlying risk considerations" and are not solely or partially based on geographic area itself. The existing law also expressly prohibits any discrimination based on race, creed, color, or national origin.

The Commission heard testimony of an apparent correlation between the high cost

territories in Baltimore City and elsewhere and the minority population within those territories. While this matter is currently before the Human Relations Commission, the Commission believes that the State insurance regulator should take additional steps to address these concerns.

First, as noted in the extensive report submitted by R & B Limited, the legal linchpin of territorial rating is the requirement that geographic distinctions be based on "underlying risk considerations." As noted in the R & B report, this term is undefined in statute or regulation. Although the Attorney General has opined that the practice followed by insurers now, justifying territories based on historical loss experience, constitutes an underlying risk consideration, the Commission believes that the interpretation and enforcement of this crucial regulatory position should rest with the State insurance regulator. Consequently, the Commission believes this term should be the subject of regulations to clarify its meaning.

Furthermore, the Commission believes that the State insurance regulator, either as part of the enforcement of the unfair discrimination provisions of the Insurance Code or as part of the determination of what constitutes acceptable underlying risk considerations, should investigate the alleged correlation between rating territories and minority population and, if appropriate, adopt regulations, within the legislative framework on territorial rating established by the General Assembly and without arbitrarily shifting automobile insurance costs from one territory to another, to ameliorate the impact of territorial rating practices on African-Americans in Baltimore City and elsewhere.

6. <u>Legislation To Reduce Accident Costs</u>

a. Cameras may be installed at high-risk intersections to photograph red-light violations.

b. Police may stop a vehicle for a seat-belt or child-restraint violation.

c. No person may use or operate a radar detector.

Explanation and justification: A clear way to reduce automobile insurance costs is to reduce automobile accident costs. A number of states, including most notably North Carolina, have undertaken aggressive highway safety measures to reduce accident costs. Information provided by the Insurance Institute for Highway Safety indicates that red-light cameras, seat-belt enforcement and radar detector prohibition are safety measures that have proven effective in reducing costs in other jurisdictions.

USF&G INSURANCE

James R. Lewis
Senior Vice President
Family and Business Insurance Group

August 31, 1995

David M. Funk, Esquire
Chairman
Governor's Commission on Automobile Insurance
Shapiro and Olander
Twentieth Floor
36 South Charles Street
Baltimore, Maryland 21201-3147

Re: Objections to Recommendations Contained in the Preliminary Report of the Governor's Commission on Automobile Insurance

Dear David:

As a member of the Governor's Commission, individually, and on behalf of USF&G and the insurance industry, I am compelled to object to several of the Recommendations contained in the Preliminary Report of the Governor's Commission on Automobile Insurance for the reasons set forth below.

Recommendation 5, relating to "regulation of territorial rating practices", is too broad and as such is not supported by the evidence. It goes beyond the charge given to the Governor's Commission to seek ways to reduce rates in Baltimore City, and the implied charge to enhance competition in Baltimore City, which was a major goal of 1995 House Bill 923. Therefore, it should be more limited in its application.

Recommendation 5(a) in unnecessary. The Maryland Insurance Commissioner, in his prior approval review of every automobile insurance rate filing, determines whether or not the underlying risk considerations, which support the rates and the rating territories used, are actuarially-justified. He is required to do so by law, and Commissioner Bartlett stated at the August 28, 1995 meeting of the Commission, that he does so. Other than the complaint of one witness that "underlying risk considerations" should be defined by the Commissioner, the evidence

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does not suggest that a definition of this term is required or needed. In the alternative, if the Legislature wishes to elaborate and expand upon the statutory relationship between geographic territories and underlying risk considerations, it should be the body to do so; not the Insurance Commissioner. Therefore, Recommendation 5(a) should be deleted, or in the alternative, directed towards the General Assembly.

Recommendation 5(b) should be amended to reflect existing law and existing powers of the Maryland Insurance Commissioner and generally limited in scope. As you are aware, Part 2, Section A of the Preliminary Report states, at page 63, that "the Commission received no credible evidence that automobile insurance rates are excessively high in Baltimore City because of overt race discrimination by the insurance industry". The reason for this statement is simple. The use of race by insurers in underwriting (which includes setting rates and establishing rating territories) is expressly prohibited by the *Maryland Insurance Code*.

During the testimony taken by the Commission, only one witness made the allegation that race is used in establishing rating territories and that there was a correlation between race and rating territories. While such blatant violations of the *Insurance Code* are difficult to imagine because of the express prohibition to the use of race, it is appropriate to assure that such a correlation does not exist. The Maryland Insurance Administration, under existing law, has the power to investigate whether or not race is used as a factor in establishing rating territories, and whether or not race is a component used in the rating of automobile insurance policies. If the Maryland Insurance Administration determines that this is the case, then the Maryland Insurance Administration should prosecute the offending companies for violations of the *Insurance Code*. Recommendation 5(b)(i) encompasses these powers and is appropriate.

Recommendation 5(b)(ii), however, goes beyond the prosecution of such offensive behavior. Recommendation 5 (b)(ii) directs the Insurance Commissioner to "ameliorate the impact of territorial rating practices on African-Americans in Baltimore City" if he finds that there is a relationship between the racial composition of the territories and rates. This recommendation does not call for prosecution, but rather, some other action to address the territorial rating practices. Redrawing, redefining or ameliorating territorial rating practices is synonymous with providing for some sort of subsidy to the affected class. This is inappropriate and should not be recommended by the Commission.

More importantly, Recommendation 5(b)(ii) appears to contravene existing Maryland law. As stated earlier, Maryland law prohibits the use of race in ratemaking and prohibits any inquiry as to race, creed, color, or national origin by an insurer on any insurance form or in the application process. This assures that the rating process used by insurers is "blind" to race. Recommendation 5(b)(ii), absent some creative recordkeeping methods, will introduce race, and, specifically, a bias in favor of African-Americans, into Maryland's rating law. It will

require some tracking of African-Americans by insurers to assure that adverse effects can be ameliorated. This is inappropriate, and if done by regulation, would force the Commissioner to contravene the *Insurance Code*. For this reason alone, Recommendation 5(b)(ii) should be deleted. In addition, Recommendation 5(b)(ii) violates the spirit of the statements made by Governor Glendening and Mayor Schmoke at the initial meeting of the Governor's Commission that they were opposed to any recommendation or program which would provide a subsidy to Baltimore City.

It must also be noted that at the August 28, 1995 meeting of the Governor's Commission, at which these recommendations were discussed, that the three African-American members of the Commission who were present objected to any reference in Recommendation 5 to race and/or to specifically highlighting African-Americans. While Messrs. Gill and Lambert wanted a recommendation that addressed territorial rating in some way, they joined me in opposing the introduction of a reference to race or African-Americans into the Recommendation. Unfortunately, the Commission chose not to accept this request from these three members.

Lastly, the reference in Recommendation 5(b)(ii) to special treatment of African-Americans in any amelioration of rating territories, provides a bias against other minorities and all other insureds. This is also inappropriate.

For all of the above reasons, Recommendation 5 should be significantly re-worked to only require that the Maryland Insurance Administration investigate whether or not race is used in the establishment of rates and rating territories; and if so, the Maryland Insurance Administration should be directed to use all of its powers to eliminate this violation of the *Insurance Code*.

I also want to comment briefly on two other points. Recommendation 3(b) should not be funded by the insurance industry. The insurance industry provides support for the Fraud Unit through increased fees, and also pays millions of dollars in premium taxes to the State of Maryland. Any pilot program should be funded with State funds, after careful consideration of the cost-effectiveness and overall propriety of such a program, giving due consideration to the veracity and value of such reports. Also it would be inappropriate for such investigators to assess liability, as one member of the Commission envisioned their role.

Lastly, while the goal of the Commission to reduce rates in Baltimore City by 20% is laudable, I am not sure that our Recommendations reach this target. I do believe that an effective no-fault bill or an effective choice no-fault bill, receiving the full support of the Governor, would be the most effective way to reduce rates. While political opposition from certain parties may detract from the value of such a program if the sponsors allow it to be

compromised, an uncompromised bill is probably the fairest and most effective way to reduce automobile rates. Therefore, the Commission should recommend that the General Assembly and/or the Governor's Office consider no-fault, and let them decide if there is appropriate political wherewithal to pass such legislation intact.

Once again, I would like to thank you for the opportunity to participate in the Commission and to file these comments.

Sincerely yours,

James R. Lewis/ja

James R. Lewis
Senior Vice President
Member of the Governor's Commission on
Automobile Insurance

JRL/sgw

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submitted 9.1.95

CITIZEN ACTION'S SUPPLEMENTARY COMMENTS ON THE PRELIMINARY REPORT OF THE GOVERNOR'S COMMISSION ON BALTIMORE CITY AUTOMOBILE INSURANCE RATE REDUCTION

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con·sen·sus \ken-'sen(t)-ses\ *n* [L, fr. *consensus, pp. of consentire*] 1 : group solidarity in sentiment and belief 2 a : general agreement : UNANIMITY b : the judgment arrived at by most of those concerned

Due to the inclusion of a number of recommendations which Citizen Action views as anti-consumer, we do not offer our support for the full report. The term "consensus" does not apply to the *Preliminary Report of the Governor's Commission on Baltimore City Automobile Insurance Rate Reduction.* In fact, use of this term to describe the Commission's report is misleading and misrepresents the nature of the Commission proceedings and of the process by which the report was created. Although no vote was taken by the Chairman, it was clear that unanimity or "consensus" did not exist. There was no "group solidarity in sentiment and belief nor was there a "judgment arrived at by most of those concerned."

Citizen Action supports recommendations to regulate territorial rating practices in order to eliminate the unfair and disproportionate economic impact that current practices have upon the African American and low income communities in Baltimore City. With the exception of this recommendation, insurance industry market practices were not addressed. We feel that this limited the effectiveness of the Commission and set an anti-consumer tone which we strongly oppose. If a vote were taken on this report, Citizen Action would offer a "nay."

Citizen Action agrees with the author of the report that "there is no room in the system for fraud." We strongly support reducing insurance fraud whether it is performed by claimants, doctors, lawyers or insurance industry employees. On the other hand, we oppose reducing or denying consumers benefits in order to reduce premiums, and we oppose recommendations which would shift costs to health insurance. In addition, we oppose recommendations which would allow insurers to collect premiums without having to pay full benefits.

According to the National Association of Insurance Commissioners December 1993 *Auto Insurance Database Report*, Maryland auto insurance companies enjoyed a 1992 statewide liability loss ratio of 63.7 for private passenger auto insurance ranking 48th in the country. This places Maryland well below the 1992 countrywide average of 72.9 (Table 7, pp14-15). Only two other states pay out less of their premium dollars to claimants than does Maryland. The same report shows that the liability loss ration for Maryland actually dropped from 81.6 with a ranking of 22nd in 1987 to the 1992 loss ratio cited above.

In 1987 Maryland insurance companies paid out nearly 82 cents for every premium dollar collected. In 1992 that number fell to nearly 64 cents. Either insurance companies have become grossly inefficient, wasting the premiums they collect, or they have become amazingly profitable.

Obviously, the insurance industry in Maryland has managed not only to decrease its liability loss ratio, but to spend out less and less of the premium dollar to consumers over the 6 years for which data is available. Yet, the Chairman of this commission chose "to make(s) no additional recommendation regarding market reform." This limited the commission to three areas (1) reducing fraud (2) reducing "underlying loss costs" and (3) reducing benefits to consumers.

Multiple Recoveries

Citizen Action opposes commission recommendations to eliminate multiple recoveries. These recommendations lower costs to the insurance industry by allowing them to collect premiums without having to pay full benefits to consumers. Recommendation 1.a. will shift expenses onto Maryland's health care system and ultimately raise health insurance rates for this already costly coverage. Any recommendation which shifts costs from auto insurance to health insurance will ultimately cost health care consumers more - this includes those who are good drivers and bad drivers, those in the city and in the suburbs.

Managed Care

Citizen Action opposes recommendation 2.a. This recommendation, if enacted, would have a negative impact on consumers in 2 ways: (1) it will take away health care choice from consumers and (2) it will create a conflict of interest.

Consumers will not be able to choose their own doctor. Rather, their choice of doctors will be limited to what their auto insurance company feels is appropriate -- even if they are currently under the special care of another physician.

The conflict of interest is clear. Auto insurance companies will make more money when they deny health care. Under this scenario, the company which provides a person's auto insurance will have a vested interest in limiting the quantity and quality of health care consumers receive if they are injured in an auto accident.

Under this scenario consumers are put in an extremely precarious position if they have been treated inadequately or unfairly. The remedy in such situations is unclear but will surely favor the auto insurance company. For example, what would be the grievance procedure under such a system? It is likely that the Auto Insurance-Managed Care Doctor would serve as a witness on behalf of the

injured party in such a situation. This is clearly a conflict of interest and dangerous for the consumer.

Medicare Proposals

Citizen Action opposes recommendation 2.b.i. which imposes a Medicare fee schedule on health care providers for soft tissue injuries and 2.b.ii which would limit the amount for which third-party defendants are liable for medical costs for soft-tissue injuries to the amount reimbursed by Medicare.

Congress is currently proposing a $270 billion dollar cut to the Medicare program. No one knows what the future holds for this program, therefore it is unwise to base any recommendation on Medicare.

In addition, Maryland already has undertaken a great deal of health care reform in HB 1359. This legislation includes the provision to develop a resource based, relative value scale doctor fee schedule that is determined on a provider basis. HB 1359 also includes a provision for an electronic claims data reporting program so that the type of care, by provider, can be tracked. Imposing a new payment plan on some providers, while developing a universal one that makes sense for all health care consumers is unwise and will create unneeded confusion.

Fraud

Once again, Citizen Action agrees with the author of the report that "there is no room for fraud in the system." Individuals found guilty of committing fraud should be prosecuted to the fullest extent of the law. This includes claimants, health care providers, lawyers and insurance industry employees and believe that such In this spirit, we support recommendation 3.b. which will create an accident reporting unit paid for by the insurance industry and recommendations 3.c.i., 3.c.ii and 3.c.iii which deal with licensing boards. Any professional found guilty of committing fraud should have their license revoked. In addition, we support recommendation 3.d. which will prevent "runners" from receiving compensation for directing or referring auto accident victims to an attorney or health care provider.

While Citizen Action supports efforts to reduce fraud, we do not support limiting benefits to all auto insurance consumers to achieve such a reduction. Recommendation 3.a. which requires physical evidence of contact punishes both good drivers and bad and therefore we cannot support it. We also oppose recommendation 3.e.ii. which would result in the punishment of the injured party not the individual who actually committed fraud. This is blatantly unfair.

Territorial Rating

Citizen Action views territorial rating as unfair and discriminatory and would like to see this practice eliminated all together. Yet, we realize the political context within which we operate. Therefore, we strongly support recommendations to regulate territorial rating practices in order to eliminate the unfair and disproportionate economic impact of such practices upon the African American and low income communities in Baltimore City.

Reducing Accidents

As to recommendation 6., we do not feel that adequate data was provided to show that these recommendations would indeed reduce auto insurance premiums in Baltimore City. We therefore withhold our support.